

# How quality assurance reviews can strengthen the strategic value of internal auditing\*

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In response to an increased focus on effective governance, the Institute of Internal Auditors (IIA) issued two key provisions to revise standards for the practice of internal audit in 2002. Of the two provisions, the external quality assurance review (QAR) is considered to be particularly important, reflecting the enhanced role played by internal audit departments in the risk, control and governance activities of many major corporations today. By January 1, 2007, the deadline for IIA compliance, it is likely that most large companies will have completed extensive external assessments. However, is the strategic potential of this effort being fully utilized by the organizations undertaking these procedures?

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Regulatory changes have placed increased demands on internal auditing departments. Quality assurance reviews provide an excellent opportunity for internal audit departments to offer greater value to their organizations and better quality assurance. But to achieve such benefits, the chief audit executive must commit to emphasizing quality assurance and improvement in the process. In our experience, this can be achieved with a well-organized, multi-step approach that focuses on establishing a stronger link between the strategic focus of internal audit and the value drivers of its key stakeholders.

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The path to enhanced strategic performance requires the chief audit executive and the internal audit department to undertake an integrated set of strategies and tactics that go well beyond adoption of and compliance with IIA standards. A stronger strategic contribution from internal audit to the objectives of the organization can be achieved by: 1) making an upfront commitment to quality, 2) conducting a sound quality assurance program, 3) establishing forward-thinking protocols, 4) conducting an external review with integrated benchmarking, 5) implementing corrective actions as necessary and 6) by continuously assessing the performance of the internal audit function.

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# Situation

Are companies  
optimizing the value  
of quality assurance  
reviews?

Recent regulatory changes have created an increased focus on effective governance. Audit committees and executive management demand more from the internal audit function in order to fulfill corporate governance responsibilities. To be responsive to such stakeholder needs, internal audit departments must operate at the highest levels of quality, and must commit to continuous evaluation and improvement of internal audit effectiveness.

On January 1, 2002<sup>1</sup>, the Institute of Internal Auditors (IIA) issued revised standards for the practice of internal audit that included two key provisions related to quality assurance: first, that internal audit departments implement a quality assurance and improvement program, and second, that they secure an external quality assurance review of their internal audit operations. The initial five-year window established by the IIA for securing an external quality assurance review closes on December 31, 2006.<sup>2</sup>

1 The Institute of Internal Auditors (IIA) issued revised standards for the practice of internal audit on January 1, 2002. These revised standards updated the IIA's International Standards for the Professional Practice of Internal Auditing.

2 Internal audit departments established after January 1, 2002, have until five years from the date they initiated operations to undergo an initial external quality assurance review.

Most internal audit departments view IIA standards as mandatory.

Although compliance with IIA standards is voluntary, most sizable companies view these standards as mandatory. Internal audit departments are not likely to ignore the commitment to quality and continuous improvement represented by the IIA standards. The external quality assurance review is considered to be particularly important in management and audit circles, reflecting the enhanced role played by internal audit departments in the risk, control and governance activities of many major corporations today.

Given the importance of the IIA standards, it is not surprising that many internal audit departments completed their external quality assurance reviews by the end of 2005 or have plans to conduct a quality assurance review by the end of 2006. By New Year's Day 2007—the deadline for complying with the two key provisions of the revised IIA standards—it is likely that most large companies will have completed an external assessment of their internal audit capabilities. Having done so, however, the question remains: have the strategic contributions of the quality assurance review been fully realized?

# Our Perspective

Link the strategic focus of internal audit with key value drivers

Compliance alone fails to leverage the power of external quality assurance reviews to enhance the strategic contributions of internal audit.

World-class internal audit groups view external quality assurance reviews as catalysts for enhancing the strategic performance of their internal audit departments by: 1) providing greater value to their organizations, 2) fostering quality assurance and improvement and 3) meeting the escalating expectations of key internal audit stakeholders.

An external quality assurance review of an internal audit department can provide a number of significant benefits. With the insights and information gained, an organization can:

- Provide independent assessment that internal audit is complying with globally recognized standards. This is an important factor in the eyes of internal audit's three primary stakeholders: 1) the audit committee, 2) senior management and 3) the organization's external auditors
- Affirm that internal audit is serving as a reliable source of information for risk, control and governance within the enterprise, a key consideration in the Sarbanes-Oxley era
- Compare the performance of the internal audit group with that of its peers
- Determine whether internal audit has the right reporting structure, people and skill sets to address enterprise-wide risk and governance issues
- Assess key stakeholder expectations, e.g., what values they expect to gain from internal audit
- Determine whether internal audit processes and practices are aligned effectively with stakeholder expectations
- Explore how to raise the stature and visibility of the internal audit group

To achieve benefits like these, the organization's chief audit executive needs to make a strong and deliberate commitment to quality assurance and improvement. By doing so, the chief audit executive can create an effective foundation for enhancing performance that will: 1) establish a strong link between the strategic focus of internal audit and the value drivers of its key stakeholders and 2) elevate the stature of internal audit within the company.

Based on our experience, we believe that a well-organized, multi-step approach is needed to strengthen the strategic performance of an internal audit group while achieving conformance with IIA standards.

# Implications

Enhanced strategic performance requires going well beyond IIA standards

The path to enhanced strategic performance requires the chief audit executive and the internal audit department to undertake an integrated set of strategies and tactics that go well beyond adoption of and compliance with IIA standards.

To ensure a successful external quality assurance review and to optimize its value, we recommend the following approach:

**Commit to quality:** Make a deliberate and documented commitment to quality assurance and improvement.

**Design and implement a quality assurance program:** Build a quality assurance and improvement program consistent with IIA standards, and put it to work.

**Implement policies and protocols:** Establish appropriate policies, procedures, and controls to enhance quality and ensure conformance with IIA standards.

**Conduct a quality assurance review:** Schedule and undergo an external quality assurance review with integrated benchmarking and strategic assessment objectives.

**Correct and enhance:** Implement all corrective actions that are recommended by the external quality assurance review to ensure conformance with IIA standards and enhancements to strategic performance.

**Assess performance:** Continuously evaluate internal audit's compliance with IIA standards and the function's overall strategic performance.

## Commit to quality

Conformance with IIA standards demands a strong, ongoing focus on quality that extends far beyond mere compliance. In 2002, with the unveiling of its new standards, the IIA said that its intent, in part, was to “...provide a framework for performing and promoting a broad range of value-added internal audit activities.”<sup>1</sup>

Make a deliberate and documented commitment to quality assurance and improvement.

<sup>1</sup> The International Standards for the Professional Practice of Internal Auditing, © 2004, The IIA, 247 Maitland Ave, Altamonte Springs, FL 32701.

The commitment to quality and continuous improvement was given additional emphasis when, in March of 2004, the US Public Company Accounting Oversight Board (PCAOB) published Auditing Standard 2<sup>2</sup>. The PCAOB standard cites the IIA standards as a benchmark by which external auditors can assess the extent to which they can rely on the work of internal auditors in completing Section 404 audits.<sup>3</sup>

The decision to conform to IIA standards should not be taken lightly. Conformity demands a significant degree of rigor that should be clearly understood by internal audit and its key stakeholders prior to making the commitment. Once the decision to conform is made, it should be clearly documented in the charter of the internal audit department and approved by the audit committee of the board of directors.

Ultimately, the success of any internal audit group stems from the degree to which it can identify the value drivers of its key stakeholders and deliver both professional and value-added internal audit services aligned with those drivers. Achieving success demands high-quality stakeholder communication supported by effective policies, procedures and processes that result in measurable internal audit results.

- 2 “Internal auditors normally are expected to have greater competence with regard to internal control over financial reporting and objectivity than other company personnel. Therefore, the auditor may be able to use their work to a greater extent than the work of other company personnel. This is particularly true in the case of internal auditors who follow the International Standards for the Professional Practice of Internal Auditing issued by the Institute of Internal Auditors.” PCAOB Auditing Standard No. 2, An Audit of Internal Control Over Financial Reporting Performed in Conjunction with an Audit of Financial Statements, PCAOB Release No. 2004-001, March 9, 2004, Public Company Accounting Oversight Board, Washington DC
- 3 Section 404 of the Sarbanes-Oxley Act of 2002 requires management to develop and monitor procedures and controls for making their required assertion about the adequacy of internal controls over financial reporting. Section 404 also requires attestation of management’s assertion by an external auditor. (Internal Auditing’s Role in Sections 302 and 404 of the US Sarbanes-Oxley Act of 2002, © 2004 by The Institute of Internal Auditors, 247 Maitland Avenue, Altamonte Springs, Florida, 32701-4201, USA)

## Design and implement a quality assurance program

To implement the IIA Standards, an internal audit group must develop and implement a quality assurance and improvement program that covers a broad range of internal audit activity and continuously monitors internal audit effectiveness.<sup>4</sup> As described in IIA Standard 1300, the program should include periodic internal and external quality assessments as well as ongoing internal monitoring.<sup>5</sup> The program should be designed to help internal audit add value, improve operations and provide assurance that the internal audit function conforms to the IIA standards and code of ethics.

4 “The chief audit executive should develop and maintain a quality assurance and improvement program that covers all aspects of the internal audit activity and continuously monitors its effectiveness. This program includes periodic internal and external quality assessments and ongoing internal monitoring. Each part of the program should be designed to help the internal auditing activity add value and improve the organization’s operations and to provide assurance that the internal audit activity is in conformity with the Standards and the Code of Ethics.”

5 Standard 1300: Quality Assurance and Improvement Program, © 2004, The IIA, 247 Maitland Ave, Altamonte Springs, FL 32701

As mandated by Standard 1300, an effective quality assurance and improvement program includes three key components:

1. **Ongoing monitoring** of the performance of the internal audit department (IIA Standard 1311)
2. **Periodic internal assessments** of the internal audit department's conformance to IIA Standards (IIA Standard 1311)
3. **External assessments** that should be "...conducted at least once every five years by a qualified independent reviewer or review team from outside the organization"

Design and implement a quality assurance and improvement program consistent with the IIA standards.

# Quick reference guide to IIA standards and practice advisories.

## Internal audit quality assurance & improvement program

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## IIA standards

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## IIA practice advisories (PA)

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Ongoing monitoring of internal audit quality

IIA Standard 1310  
IIA Standard 1311

PA 1310-1  
PA 1311-1

Periodic internal audit assessments

IIA Standard 1310  
IIA Standard 1311

PA 1310-1  
PA 1311-1

External quality assessment reviews

IIA Standard 1310  
IIA Standard 1312

PA 1310-1  
PA 1312-1

To foster effective quality assurance and improvement throughout the profession, the IIA has published a series of non-mandatory practice advisories that interpret and expand on the organization's standards. The opposite page provides a quick reference to IIA standards and related practice advisories that may be consulted by chief audit executives seeking to establish and maintain a quality assurance and improvement program.

## Success factors for internal audit quality assurance programs

Our experience with a wide range of internal audit groups suggests that the effectiveness of a quality assurance and improvement program is influenced by several key success factors. These success factors pertain to each of the three main components of a quality assurance program:

**Ongoing monitoring of internal audit performance:** Successful quality assurance programs are invariably built on a continuous commitment to quality. The chief audit executive should ensure that quality is continuously monitored through such initiatives as supervisory reviews of work papers; internal quality/peer reviews of completed engagements; and ongoing measurement and analyses of performance metrics such as client satisfaction and audit cycle time.<sup>6</sup>

**Periodic internal assessments of internal audit conformance to IIA standards:** In conducting external quality assurance reviews, we have noted that some internal audit departments overlook the requirement to conduct periodic internal audit assessments—a serious mistake, in our view. IIA Standard 1310 and the related IIA practice advisories clearly state that periodic assessments are a key component of a conforming quality assurance and improvement program. Moreover, it is important for those conducting such periodic assessments to report directly to the chief audit executive, as outlined in IIA Practice Advisory 1311-1.<sup>7</sup>

6 Practice Advisory 1310-1, “Quality Program Assessments,” © 2004, The IIA, 247 Maitland Ave, Altamonte Springs, FL 32701

7 Practice Advisory 1311-1, “Internal Assessments,” © 2004, The IIA, 247 Maitland Ave, Altamonte Springs, FL 32701 – While periodic internal assessments of internal audit conformance to IIA Standards are mandated in standard 1311, it should be noted that the specific provisions of Practice Advisory 1311-1 represent “optional guidance” for considerations when implementing the standards. In addition, the recommended structure and formal nature of periodic internal assessments is clearly outlined in Practice Advisory 1311-1, which states: “The chief audit executive should establish a structure for reporting results of periodic reviews that maintains appropriate credibility and objectivity. Generally, those assigned responsibility for conducting ongoing and periodic reviews should report to the chief audit executive while performing the reviews and should communicate their results directly to the chief audit executive.”

**External assessments:** Many chief audit executives consider an external assessment a critical step in the overall quality assurance and improvement process. In addition to confirming compliance with IIA standards, a well-designed external assessment will provide benchmarks and measurements that can be used to continuously improve internal audit performance long after the external quality assurance review report is issued. When considering an external quality assurance review provider, chief audit executives should consider not only the provider's experience in assessing compliance with the standards, but also in assessing high-performing internal audit departments in their industry.

In addition to these key success factors, formal documentation of the quality assurance process should be viewed as a standard operating procedure, even though it is not specifically mandated by the IIA standards.

## Implement policies and protocols

Once internal audit makes a strong commitment to quality and has designed the elements of a quality assurance program, the chief audit executive should conduct a comprehensive gap analysis to determine where internal audit needs to strengthen its operations in order to comply with IIA standards.

To perform a gap analysis, review the eleven standards for the professional practice of internal auditing that have been developed by the IIA. Four standards deal with attributes; seven deal with performance. The standards should be the first source of benchmarking when conducting a gap analysis.

The appendix of this paper includes suggested questions that should be addressed in each of the eleven IIA standards. These questions can serve as a useful tool when conducting a preliminary gap analysis to assess compliance with the IIA Standards.

Appropriate policies,  
procedures and controls help  
ensure conformity with  
the IIA standards.

## Eleven standards for the internal auditing profession

### Attribute standards

1. Purpose, authority and responsibility (Standard 1000)
2. Independence and objectivity (Standard 1100)
3. Proficiency and due professional care (Standard 1200)
4. Quality assurance and improvement program (Standard 1300)

### Performance standards

5. Managing the internal audit activity (Standard 2000)
6. Nature of work (Standard 2100)
7. Engagement planning (Standard 2200)
8. Performing the engagement (Standard 2300)
9. Communicating results (Standard 2400)
10. Monitoring progress (Standard 2500)
11. Resolution of management's acceptance of risks (Standard 2600)

While compliance with each of the four attributes and seven performance standards is necessary, our experience in performing external quality assurance review engagements suggests that deficiencies in conformity with some standards are more common than with others. When implementing the standards for the first time, or when preparing for an external quality assurance review, chief audit executives should pay particular attention to the following areas:

**Charters:** An internal audit charter must be formulated, regularly updated and submitted to the audit committee of the board of directors for approval. The charter should reflect the nature of the current services being performed by internal audit (IIA Standard 1100).

**Reporting structure:** The chief audit executive should ensure that he/she reports to a level within the organization that allows the internal audit department to be free from interference in determining the scope of internal auditing, performing work and communicating results (IIA Standard 1000 and 1000.A.1).

**Policies and procedures:** The chief audit executive should establish policies and procedures to ensure conformity with the IIA standards, and to provide guidance to the internal audit department (IIA Standard 2040). Among other areas, these policies should address:

- Proficiency and due professional care (IIA Standards 1200-1230)
- The quality assurance and improvement program (IIA Standards 1300-1340)
- Engagement planning (IIA Standards 2200-2240)
- Engagement performance (IIA Standards 2300-2340)
- Communication of engagement results (IIA Standards 2400-2440)
- The follow-up process (IIA Standard 2500)
- The process for resolution of management's acceptance of risks (IIA Standard 2600)

**Risk assessment:** The chief audit executive should direct internal audit to conduct a risk assessment, either annually or at more frequent intervals, to serve as the basis for internal audit's plan of engagements (IIA Standard 2010).

**Stakeholder input:** Internal audit's risk assessments—whether annual or at the engagement level—should include input from those knowledgeable about operations or potential risks, such as senior management and the board (IIA Standard 2010.A.1 and 2201).

**Chief audit executive reports:** The chief audit executive should provide the board and senior management with periodic reports on the internal audit function. These reports should address the purpose, authority and responsibility of the function as well as the audit group's performance vs. plan (IIA Standard 2060).

**Audit tracking system:** The chief audit executive should ensure that internal audit has developed a follow-up tracking system to monitor the disposition of audit results (IIA Standard 2500).

In considering essential areas like these, the perspectives and expectations of internal audit's stakeholders (senior management, the audit committee and the organization's external auditors) should provide strong guidance in terms of how the function should assess and report on risks, controls and governance within the organization.

Ultimately, the success of any internal audit group stems from the degree to which it can assess the value drivers of its key stakeholders and create a plan to deliver internal audit services that align effectively with the values of those stakeholders.

## Conduct a quality assurance review

Significant preparation is required to achieve a successful external quality assurance review. A good place to start is to review the IIA's Quality Assessment Manual, which offers a number of excellent tools for completing a self-assessment in advance of the external assessment.

A chief audit executive also needs to evaluate departmental conformity to IIA standards at a high level. A periodic internal assessment, as discussed previously, can serve as an effective means of determining internal audit's progress in terms of quality assurance, as well as its readiness to undergo an external assessment.

Which type of external quality assurance review format and methodology to employ should be decided early in the process. The IIA has outlined two alternative approaches: a full external quality assessment or a self-assessment with independent validation.

Our experience has shown that chief audit executives who opt for a self-assessment with independent validation are often surprised and disappointed by the level of internal audit resources that must be dedicated. While a tempting option on the surface, the self-assessment with independent validation requires extensive analyses and documentation that must be completed in advance of the independent validation.

Schedule and undergo an external quality assurance review with integrated benchmarking and strategic assessment objectives.

For most large internal audit departments, the full external quality assessment using a provider experienced in determining compliance with IIA standards and equipped with industry-specific best practices is a superior choice for an external quality assurance review. According to IIA Practice Advisory 1312-1, a full external assessment should address:

- **Compliance** with the IIA's standards and code of ethics
- **Internal audit's charter**, plans, policies, procedures, practices and applicable legislative and regulatory requirements
- **Key stakeholder perspectives**, including expectations of the board of directors, audit committee, executive and operational management pertaining to the internal audit department
- **Integration of internal audit within the organization's governance process**, including the relationships between and among participating groups
- **Tools and techniques** for internal audit
- **Staff assessment**, including a discussion of the knowledge and experience held by the internal audit staff, the disciplines represented within the department, and the staff focus on process improvement
- **Charter evaluation**, a determination as to whether internal audit is fulfilling its charter and organizational expectations<sup>8</sup>

8 Ibid.

A chief audit executive also needs to identify a qualified external reviewer to lead the assessment. In Practice Advisory 1311-1, the IIA outlines the basic qualifications for external quality assurance review evaluators.<sup>9</sup>

IIA Practice Advisory 1311-1 also suggests that individuals who conduct external quality assurance reviews should be: 1) competent, certified internal audit professionals knowledgeable about the IIA's standards, 2) ideally possess either a CIA, CPA, CA or CISA certification, 3) well versed in the best practice of internal audit, and 4) should possess at least three years of recent experience in the practice of internal auditing at a management level.<sup>10</sup>

This guidance from the IIA provides a good starting point for considering potential external evaluators. However, a number of other factors should also be considered by chief audit executives preparing a request for proposal or other means for soliciting candidates to conduct an external review. For example, it is important to think about:

9 External reviewers, including those who validate self-assessments...should be independent of the organization and of the internal audit activity. The review team should consist of individuals who are competent in the professional practice of internal auditing and the external assessment process. To be considered as external assessment candidates, qualified individuals could include IIA quality assurance reviewers, regulatory examiners, consultants, external auditors, other professional service providers, and internal auditors from outside the organization."

10 Practice Advisory 1311-1, "Internal Assessments," © 2004, The IIA, 247 Maitland Ave, Altamonte Springs, FL 32701 – While periodic internal assessments of internal audit conformance to IIA Standards are mandated in standard 1311, it should be noted that the specific provisions of Practice Advisory 1311-1 represent "optional guidance" for considerations when implementing the standards. In addition, the recommended structure and formal nature of periodic internal assessments is clearly outlined in Practice Advisory 1311-1, which states: "The chief audit executive should establish a structure for reporting results of periodic reviews that maintains appropriate credibility and objectivity. Generally, those assigned responsibility for conducting ongoing and periodic reviews should report to the chief audit executive while performing the reviews and should communicate their results directly to the chief audit executive."

- **Value to be delivered beyond simply indicating conformity to the IIA standards:** Intrinsic gains from the external quality assurance review become critical factors in leveraging the review to enhance internal audit's strategic performance. Choosing an external quality assurance review provider with extensive experience in benchmarking against other high-performing internal audit departments, and in assisting internal audit departments with the design and implementation of both strategic and transformational change, could be helpful. An external quality assurance review provider should be familiar with benchmarking tools that can be used to evaluate internal departments in the same or related industries.
- **Provider experience in delivering external quality assurance reviews focused on compliance with IIA standards:** Since the external quality assurance review requirement is relatively new, an internal audit group may not want to serve as a test case for a new or fledgling provider. A provider with extensive experience in conducting external quality assurance reviews under the current IIA standards can benefit an organization in need of deep expertise.
- **Knowledge and internal audit experience of the prospective engagement team:** Beyond examining the corporate reputation and experience of an external quality assurance review provider, a chief audit executive would be well advised to look at the individual qualifications of a prospective quality assurance review team. Solid experience is a significant asset during particularly delicate aspects of the external quality assurance review process, such as conducting stakeholder interviews and benchmarking departmental performance against other high-performing internal audit groups.
- **Methodologies to be employed:** Most independent evaluators leverage the methodology outlined by the IIA in its Quality Assessment Manual. However, a chief audit executive should understand the prospective methodologies to be employed in validating conformity with the IIA standards and in benchmarking and assessing the strategic performance of internal audit. Chief audit executives should not hesitate to ask prospective providers to outline their methodologies, project milestones and deliverables in their external quality assurance review proposals.

## Correct and balance

The external quality assurance review process should not end with the receipt of a report indicating the extent of conformity with IIA standards. Instead, the report should provide a set of actionable recommendations intended to ensure conformity with IIA standards and to enhance the strategic performance of the internal audit department.

In addition to a report card on compliance with IIA standards, a strategically focused external quality assurance review will also include:

- A benchmarking analysis that indicates the extent to which internal audit has adopted best practices
- An assessment of how well an internal audit function is adding value to the company and meeting the expectations of key stakeholders
- A strategic plan directed toward implementing changes needed to improve performance and value
- A tactical action plan outlining specific change initiatives

Implement corrective actions recommended in the external quality assurance review to ensure conformity to IIA standards and enhancements to strategic performance.

External quality assurance review service providers are likely to differ in their frameworks for assessing the strategic performance of internal audit. However, we believe such assessments should focus on a set of core processes, including organization, human resources, technology, working practices, communications and reporting, knowledge management and performance metrics.

The assessment of internal audit's strategic performance should not be limited to current and past performance. Rather, it should also include specific actionable recommendations to enhance future performance.

Upon receipt of the final external quality assurance review report, a chief audit executive needs to take two critical actions. First, according to the provisions of IIA Standard 1320, the chief audit executive should communicate the results of the quality assurance review to the board of directors. Second, IIA Practice Advisory 1320-1 calls for the chief audit executive to prepare a written action plan that lays out how internal audit will conform to standards, enhance its strategic performance and respond to significant comments and recommendations contained in the report of external assessment.<sup>11</sup>

11 Practice Advisory 1320-1: Reporting on the Quality Program, © 2004, The IIA, 247 Maitland Ave, Altamonte Springs, FL 32701

## Assess performance

Quality assurance and improvement are continuous processes that do not end with an external quality assurance review. In fact, an external quality assurance review should serve in large measure as an indicator of the progress being made and as a blueprint for enhancements.

Specific action plans should be formulated and implemented to remedy any deficiencies. In addition, organizations should continually assess and measure internal audit's performance as part of the quality assurance and improvement program. Input gathered from an external quality assurance review allows organizations to modify the ongoing monitoring aspect of the quality assurance program to focus on areas targeted for improvement. These same areas can be the focus of periodic internal assessments.

The second, and perhaps even more critical, outcome of an external quality assurance review should be the basis for strategic enhancements to the internal audit department. A key component of a post-external quality assurance review action plan should be the design and implementation of a performance measurement system for internal audit. Such a system can take the form of a "balanced scorecard" or a similar systemic and disciplined approach to measuring performance and ensuring improvement in areas identified by the external quality assessment review. Ideally, a performance measurement system should focus on factors such as stakeholder satisfaction with internal audit's performance.

If the external quality assurance review report highlights significant gaps or opportunities for improvement, these can serve as the basis for the design and implementation of a plan for comprehensive strategic or transformational change for the department. Central to success in such an endeavor is ensuring that internal audit is aligned to the value drivers of key stakeholders—with continuous assessment of strategic or transformational plans. Specific performance metrics should be formulated for each major objective of the plan. On the basis of periodic assessments, such plans can be revised or accelerated as appropriate.



Continuously assess internal audit's compliance with IIA standards, and assess the function's overall strategic performance. Integrate performance measurement into a quality assurance and improvement program.

# Appendix I: Questions for gap analysis

IIA Standard

## **1000 Purpose, authority, and responsibility**

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- Are the purpose, authority, and responsibility for internal audit formally defined in a charter?
- Has the charter been recently reviewed and approved by the Audit Committee?
- Is the nature of any consulting services being offered by internal audit defined in the charter?

## **1100 Independence and objectivity**

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The internal audit activity should be independent, and internal auditors should be objective in performing their work.

- Does internal audit report to an appropriate level?
- Is the internal audit organization free from interference?
- Do corporate policies foster individual objectivity?

# Questions to be considered by the chief audit executive during a preliminary gap analysis

## 1200 Proficiency and due professional care

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The purpose, authority and responsibility of the internal audit department should be clearly defined. Engagements should be performed with proficiency and due professional care.

- Is the internal audit staff proficient?
- Is the IT expertise of the internal audit function adequate?
- Does internal audit seek outside expertise when warranted?
- Do internal audit policies foster due professional care?
- Does internal audit deploy IT tools when warranted?
- Are members of the internal audit staff adequately trained and educated?

## 1300 Quality assurance and improvement program

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The chief audit executive should develop and maintain a quality assurance and improvement program that covers all aspects of the internal audit activity and continuously monitors its effectiveness.

- Have policies and procedures been prepared for internal audit?
- Does internal audit undertake a comprehensive annual risk assessment?
- Is the annual plan for internal audit based on an annual risk assessment?
- Is the annual internal audit plan approved by the audit committee?
- Does the chief audit executive coordinate with other oversight activities, such as risk management or compliance?
- Does the chief audit executive inform senior management and the audit committee about internal audit's resource requirements and limitations?

## 2000 Managing the internal audit activity

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The chief audit executive should effectively manage the internal audit activity to ensure it adds value to the organization.

- Have policies and procedures been prepared for internal audit?
- Does internal audit undertake a comprehensive annual risk assessment?
- Is the annual plan for internal audit based on an annual risk assessment?
- Is the annual internal audit plan approved by the audit committee?
- Does the chief audit executive coordinate with other oversight activities, such as risk management or compliance?
- Does the chief audit executive inform senior management and the audit committee about internal audit's resource requirements and limitations?

## 2100 Nature of work

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The internal audit activity should evaluate and contribute to the improvement of risk management, control, and governance processes using a systematic and disciplined approach.

- Does internal audit monitor and evaluate risk management systems?
- Does internal audit foster effective controls within the company?
- Within your organization, does internal audit:
  - Assess corporate governance?
  - Promote appropriate ethics and values?
  - Ensure effective organizational performance management and accountability?
  - Effectively communicate about risk and control issues?
  - Effectively facilitate the exchange of information among the board, external and internal auditors, and management?

## 2200 Engagement planning

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Internal auditors should develop and record a plan for each engagement, including the objectives, scope, timing and resource allocations.

- Is there an engagement work program for each internal audit engagement?
- Is a preliminary risk assessment conducted when planning engagements?
- Are engagement objectives a logical extension of a risk assessment process?
- Does the engagement scope adequately address engagement objectives?
- Do engagements have adequate resources?

## 2300 Performing the engagement

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Internal auditors should identify, analyze, evaluate and record sufficient information to achieve the engagement's objectives.

- Do internal audit work papers appropriately document information?
- Are engagements properly supervised?
- Do auditors identify, analyze, evaluate and record sufficient information to achieve engagement objectives?
- Has the engagement team identified a sufficient amount of reliable, relevant and useful information to achieve engagement objectives?

## **2400** **Communicating results**

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Internal auditors should communicate the engagement results.

- Are engagement results properly communicated to management?
- Are the communications pertaining to internal audit engagements as being accurate, objective, clear, concise, constructive, complete and timely?
- Are engagement communications properly supported by work papers?
- Are engagement results disseminated to appropriate parties?

## **2500** **Monitoring progress**

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The chief audit executive should establish and maintain a system to monitor the disposition of results communicated to management.

- Has a process been established to monitor the implementation of internal audit recommendations?
- Are engagement results followed up in a timely manner?

## 2600 Resolution of management's acceptance of risks

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When the chief audit executive believes that senior management has accepted a level of residual risk that may be unacceptable to the organization, the chief audit executive should discuss the matter with senior management. If the decision regarding residual risk is not resolved, the chief audit executive and senior management should report the matter to the board for resolution.

- When management disagrees with the recommendations of internal audit, is there a process in place to resolve such disagreements with the board of directors?
- If such a resolution process exists, does it allow for escalation of disagreements until resolved by the audit committee or the board?



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