Value-Added Internal Audit: Myth or Reality?

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Past Chairman of the Board IIA
Past President ECIIA
Polling question #1

For how long have you been an internal auditor?

1. Less than 3 years
2. More than 3 years but less than 10 years
3. More than 10 years
4. I am not an internal auditor
Polling question #2

Have you already performed an internal quality assessment of your internal audit function?

1. Yes
2. No
Polling question #3

Have you already performed an external quality assessment of your internal audit function?

1. Yes
2. No
Three lines of defense model

1st Line of Defense
- Management Controls
- Internal Control Measures

2nd Line of Defense
- Financial Control
- Security
- Risk Management
- Quality
- Inspection
- Compliance

3rd Line of Defense
- Internal Audit
- External audit / NAO
- Regulator
Some critical thoughts

1. Can Senior Management and a Board of Directors or an Audit Committee perform their role without a qualified internal audit function?

2. How does Senior Management and a Board of Directors or the Audit Committee obtain assurance on the performance of the internal audit function?
Value of Internal Audit

The internal audit function should be able to tell:

- when the company is being poorly managed,

- where critical risks are not being identified or properly managed,

- when the business objectives are not likely to be met.
Value of Internal Audit

In addition, internal audit:

• acts as a training ground for future line managers, by exposing fast track members of the department to a variety of situations, activities and functions within the organization;

• provides a “one stop shop” for best practice advice;

• provides an independent, objective opinion as to the quality of the business controls;

• stimulates risk awareness throughout the organization;
Value of Internal Audit

In addition, internal audit (continued):

• is a source of qualified, experienced talent that can aid management in business improvement programs;

• provides specialist professional independent opinions on a variety of situations, such as due diligence exercises;

• reports on fraudulent activity within the organisation, with a view to understanding how it happened and how to prevent it occurring again;

• ensures that the company-wide initiatives, such as a code of conduct, are being adhered to;

• makes Senior Management and the Board sleep well at night.
Quality Assessment Review

IIA Standards Scorecard Example

<table>
<thead>
<tr>
<th>Rating</th>
<th>IIA Attribute Standards</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1000 - Purpose, Authority, and Responsibility</td>
</tr>
<tr>
<td></td>
<td>1100 – Independence and Objectivity</td>
</tr>
<tr>
<td></td>
<td>1200 – Proficiency and Due Professional Care</td>
</tr>
<tr>
<td></td>
<td>1300 – Quality Assurance and Improvement Program</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Rating</th>
<th>IIA Performance Standards</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2000 – Managing the Internal Audit Activity</td>
</tr>
<tr>
<td></td>
<td>2100 – Nature of Work</td>
</tr>
<tr>
<td></td>
<td>2200 – Engagement Planning</td>
</tr>
<tr>
<td></td>
<td>2300 – Performing the Engagement</td>
</tr>
<tr>
<td></td>
<td>2400 – Communicating Results</td>
</tr>
<tr>
<td></td>
<td>2500 – Monitoring Progress</td>
</tr>
<tr>
<td></td>
<td>2600 – Resolution of Management’s Acceptance of Risks</td>
</tr>
</tbody>
</table>

- Green: Generally conforms to the relevant structures, policies, and procedures of the activity, as well as the processes by which they are applied, complies with the requirements of the individual Standard.
- Yellow: Partially conforms to the activity and is making good-faith efforts to comply with the requirements of the individual Standard.
- Red: Does not conform to the activity and is not aware of, is not making good-faith efforts to comply with, or failing to achieve many/all of the objectives of the individual Standard.
Different layers of assessment

**Strategy:**
- Mission and charter
- Strategic objective setting
- Strategic organizational model
- Performance evaluation

**Technology:**
- Data analytics and tools
- Knowledge management
- Technology efficiencies
- Automated audit software

**Structure:**
- Alignment with corporate strategy
- Alignment with people strategy
- Departmental structure
- Credibility within the company

**People:**
- Career Development
- Roles
- Skills
- Staffing

**Process**
- Methodology
- Risk assessment
- Audit plan
- Engagement planning
- Execution

**Reporting**
- Communication
- Issue tracking and follow-up
- Internal and external Assessment
## The Structural elements of an Internal Audit Function

### Supporting Processes

<table>
<thead>
<tr>
<th>Activity organization and management</th>
<th>Human Resources</th>
<th>Information Technology</th>
<th>Planning</th>
<th>Performance</th>
<th>Communication and reports</th>
</tr>
</thead>
<tbody>
<tr>
<td>Vision, values, &amp; strategic objectives</td>
<td>Constitution of a team of experts</td>
<td>Electronic management system of work files</td>
<td>Mapping of company risks</td>
<td>Information on objectives and expectations for each mission</td>
<td>Communication / Reporting to audited entities</td>
</tr>
<tr>
<td>Structure and organisation (Processes / Methods)</td>
<td>Recruitment</td>
<td>Specific applications and technologies</td>
<td>Knowledge of internal audit clients expectations</td>
<td>Collaboration with the audited entity</td>
<td>Communication / Reporting to management</td>
</tr>
<tr>
<td>Resource management</td>
<td>Training and personal development</td>
<td>Database of best practices</td>
<td>Internal audit plan</td>
<td>Needs for expertise evaluation and responses to main issues</td>
<td>Communication / Reporting to audit committee</td>
</tr>
<tr>
<td>Activity measurement</td>
<td>Internal communication</td>
<td></td>
<td>Coordination with external auditors and other control entities</td>
<td>Work Program</td>
<td>Communication with external auditors and other control entities</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Resources assignment</td>
<td>Tests and analysis</td>
<td>Internal audit clients satisfaction measurement</td>
</tr>
<tr>
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<td></td>
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<td></td>
<td>Work documentation</td>
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<td></td>
<td></td>
<td></td>
<td>Engagement supervision</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Follow up</td>
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### Evaluation Criteria

- **Satisfying**
- **Room for improvement**
- **Need for improvement**
- **Not applicable**
- **Out of scope**

*The structural elements in a shaded color frame appear in the IIA (Institute of Internal Auditors) professional standards*
**Example of KPIs**

<table>
<thead>
<tr>
<th>Dimension</th>
<th>KPI</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Audit Committee and Executive Management</strong></td>
<td>• AC/EM survey rating</td>
</tr>
<tr>
<td></td>
<td>• Materiality level of audit findings</td>
</tr>
<tr>
<td></td>
<td>• Percentage of unsatisfactory ratings</td>
</tr>
<tr>
<td></td>
<td>• Number of frauds per annum and value of frauds</td>
</tr>
<tr>
<td></td>
<td>• Number of complaints from regulatory bodies</td>
</tr>
<tr>
<td></td>
<td>• Number of auditors per 1000 employees</td>
</tr>
<tr>
<td></td>
<td>• Percentage of audit universe covered per year</td>
</tr>
<tr>
<td><strong>Audit Clients</strong></td>
<td>• Satisfaction survey rating</td>
</tr>
<tr>
<td></td>
<td>• Percentage of subject matters in the audit plan identified by the business lines</td>
</tr>
<tr>
<td></td>
<td>• Percentage of unsatisfactory rating/compliance</td>
</tr>
<tr>
<td></td>
<td>• Percentage of issues open/closed/past due per business line</td>
</tr>
<tr>
<td></td>
<td>• Number of best practices identified in the business line</td>
</tr>
<tr>
<td></td>
<td>• Percentage of recommendations accepted/refused</td>
</tr>
<tr>
<td></td>
<td>• Number of repeat findings</td>
</tr>
<tr>
<td></td>
<td>• Number of requests by local management for audit support</td>
</tr>
<tr>
<td></td>
<td>• Average response time to management requests for support</td>
</tr>
<tr>
<td><strong>Audit Processes</strong></td>
<td>• Percentage of audits performed versus plan</td>
</tr>
<tr>
<td></td>
<td>• Percentage of time spent on automated/manual controls</td>
</tr>
<tr>
<td></td>
<td>• Average number of SAP standard queries used per audit</td>
</tr>
<tr>
<td></td>
<td>• Mean time from closing meeting to report issuance</td>
</tr>
<tr>
<td></td>
<td>• Percentage of annual audit costs versus annual budget</td>
</tr>
</tbody>
</table>
## Key Performance Indicators (2/2)

### Example of KPIs

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<thead>
<tr>
<th>Dimension</th>
<th>KPI</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Innovation and Capabilities</strong></td>
<td>• Percentage of auditors with university degrees</td>
</tr>
<tr>
<td></td>
<td>• Percentage of auditors with economic/engineering/mathematics/etc. education</td>
</tr>
<tr>
<td></td>
<td>• Number of years of relevant business experience</td>
</tr>
<tr>
<td></td>
<td>• Number of years of audit experience</td>
</tr>
<tr>
<td></td>
<td>• Percentage of certified auditors</td>
</tr>
<tr>
<td></td>
<td>• Percentage of planned/unplanned staff turnover per year</td>
</tr>
<tr>
<td></td>
<td>• Percentage of planned leavers being promoted in the organization</td>
</tr>
<tr>
<td></td>
<td>• Audit group rating by staff members</td>
</tr>
<tr>
<td></td>
<td>• Number of training hours per auditor and year</td>
</tr>
<tr>
<td></td>
<td>• Percentage of auditors rated per year</td>
</tr>
<tr>
<td></td>
<td>• Percentage of auditors with rating above/below expectations</td>
</tr>
<tr>
<td></td>
<td>• Average peer review rating (quality rating given by peer reviewer to a specific file)</td>
</tr>
<tr>
<td><strong>Internal Stakeholders</strong></td>
<td>• Number of ERM steering committee and work group meetings</td>
</tr>
<tr>
<td></td>
<td>• Number of significant initiatives developed/implemented</td>
</tr>
<tr>
<td></td>
<td>• Number of audit subjects within the internal audit plan coming from the external auditors</td>
</tr>
<tr>
<td></td>
<td>• Number of external audit hours saved and effectiveness enhanced as a result of internal audit initiatives</td>
</tr>
<tr>
<td></td>
<td>• Number of audit subjects within the external audit plan coming from IA</td>
</tr>
</tbody>
</table>
Polling question #4

Have you developed meaningful metrics for your internal audit function?

1. Yes
2. No
Internal audit in practice(1)

• Internal audit does not always provide assurance.

• Internal audit does not always provide value-added consulting services.

• Internal audit does not often evaluate the governance processes.

• Internal audit does not often evaluate the risk management processes.
Polling question #5

Do you audit the governance processes within your organization?

1. Yes
2. No
Polling question #6

Do you audit the risk management processes within your organization?

1. Yes
2. No
Internal audit in practice (2)

• Internal audit operates as a second line of defense.

• Internal audit acts and is perceived as a compliance function.

• Internal audit inspects branches, stores.
Three lines of defense model

1st Line of Defense
- Management Controls
- Internal Control Measures

2nd Line of Defense
- Financial Control
- Security
- Risk Management
- Quality
- Inspection
- Compliance

Senior Management

Board of Directors / Audit Committee

External audit / NAO

Regulator
Polling question #7

Is more than 50% of your audit plan focused on compliance risks?

1. Yes
2. No
Perception by stakeholders

- No added value.
- No business partner.
- No alignment with company strategy.
- Fear factor: from errors to punishment.
- No managerial talent.
- No meaningful KPIs.
- Not focused on the proper risks.
Polling question #8

Do you consider internal audit to be a business partner to your organization?

1. Yes
2. No
Polling question #9

Do the CEO / President and senior management of your organization consider you to be a business partner?

1. Yes

2. No
Conditions of audit committees

• No proper monitoring of risk management, internal control and internal audit.

• Not always properly staffed.

• Not well prepared.

• No support when needed.

• No voice at the Board.
Polling question #10

Do you feel internal audit to be supported by the Audit Committee / Board of Directors in your organization?

1. Yes
2. No
Conditions of companies

• No risk and control culture.
• No risk ownership.
• No accountability.
• Control is not my business.
• Cost cutting affects control tasks.
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MYTH
What to do to change myth into reality?

• At macro-level: the Institute of Internal Auditors (TIDE)

• At micro-level: every Chief Audit Executive
Efforts by the CAE (1)

• Internal audit should be an agent for change:
  – Change the risk and control culture of your organization.
  – Coordinate risk management activities.
  – Develop an assurance map for your organization.
Polling question #11

Do you contribute to the development of an assurance map in your organization?

1. Yes
2. No
Efforts by the CAE (2)

• Focus on the areas that need to be audited, not what is easy to audit.

• Provide assurance on major risks.

• Audit the second lines of defense and, if OK, rely on the results of their work.

• Do not duplicate second line of defense activities.
Efforts by the CAE (3)

• Develop a comprehensive audit universe.

• Assess the risks on a periodical basis.

• Do not adhere to your audit plan in a rigid way.

• Develop metrics that are relevant for your stakeholders.
Efforts by the CAE (4)

• Write reports with impact.

• Do not focus on problems, but offer solutions.

• Solutions should not be academic but rather pragmatic.

• Listen to your stakeholders.
Polling question #12

How would you assess the overall value of the internal audit function in your organization?

1. It is a state-of-the-art practice.
2. Some minor improvements are needed.
3. Some major improvements are needed.
4. There is a lot of work to do.
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