The Path to Quality

... a step-by-step guide to world-class internal auditing

Quality can be viewed as the characteristic of adding value through meeting stakeholder needs and expectations.

The Institute of Internal Auditors (IIA) understands that internal audit quality is achieved over time. And, achieving quality requires the understanding not only by those performing internal auditing but also by audit customers as well as those responsible for internal audit oversight. In addition, maintaining and improving quality requires a concentrated commitment and diligence on the part of the chief audit executive (CAE), as an organization and its culture change.

Quality is a key requirement of The IIA’s International Standards for the Professional Practice of Internal Auditing (Standards) for all Internal Audit Activities (IAA’s). However, Internal Audit shops exist in all sizes, of all complexities, and with differing resources and levels of experience, knowledge, and sophistication and consequently with differing quality capabilities. To support these diverse internal audit shops, The IIA has developed a Path to Quality Model (PTQM) and this step-by-step guide for continuous improvement. Based on proven practices, this simple, user-friendly guide categorizes messages and tools that will help CAE’s stay on track as they venture forward on the path to quality.

The PTQM provides a framework for the CAE to assess the current state of the IAA’s quality capability, target an appropriate level of quality capability for the IAA, and lay out the steps along a path for the IAA to reach its quality capability target.

There are five levels of quality capability described in the PTQM. Level 3 is the quality capability threshold target for many IAA’s as it means that an evaluation of “Generally Conforms” with the Standards has been determined by an external assessment.

Below Level 3, the quality capability of the IAA has not achieved general conformance with the Standards either because an external assessment has not been performed (Level 1) or an external assessment has evaluated the IAA as not being in general conformance with the Standards (Level 1 - “Does Not Conform” or Level 2 - “Partially Conforms”). Levels 1 and 2 may represent a start-up IAA or an IAA that has an intention to develop the required quality capability for conforming to the Standards. A CAE’s first step toward increasing quality capability is to establish a Quality Assurance and Improvement Program.

IAA’s at Levels 4 and 5 of the PTQM have achieved General Conformance with the Standards as determined by an external assessment. But, these higher levels of quality capability (Levels 4 and 5) add additional value to their organizations through more advanced use of Best Practices in implementing the Standards. Levels 4 and 5 are not
measures that are evaluated by an external assessment, but are determined by the CAE with input from others, as required.

The complexity of the organization and size of the IAA may be characteristics that influence the current and targeted level of quality capability.

The following descriptors of the various levels should be considered by the CAE in assessing the IAA's current level and the target level for quality capability. The indicated steps are offered to the CAE to provide assistance in building quality capability.

**LEVEL ONE - BEGINNING**

A LEVEL-ONE Internal Audit Activity (IAA) typically will be either fairly new or an existing IAA that does not formally follow the Standards. To begin on the Path to Quality, the CAE, the Board, and senior management must commit to moving towards conformance with the Standards and identifying and managing the IAA's risks. A first step is to begin to develop a Quality Assurance and Improvement Program. The Standards require an External Assessment at least every five years; however an effective Quality Assurance and Improvement Program through on-going monitoring and self-assessments will provide a means for the CAE to measure progress towards conformance on a more current basis. An appropriate first target for a LEVEL ONE IAA is LEVEL TWO in which the IAA is making substantial progress towards risk management and conformance with the Standards.

**KEY MESSAGES**

- Although quality sometimes might be considered a subjective concept, The IIA promotes objectively monitoring, improving, and reporting on quality, as defined by the values of an organization and the needs of its stakeholders.

- The rapid growth in the field of and demand for internal auditing has resulted in the implementation of new internal audit activities in many organizations for the first time.

- Results from The IIA Research Foundation's recent Common Body of Knowledge (CBOK) survey also point to the growth in the number of internal audit activities established within the past few years, and the fact that many of these new shops are not yet up to par in regard to assessing and documenting their quality.

- Because the establishment of a new internal audit shop requires a significant commitment of an organization's attention, time, and resources, it is realistic to expect "young" internal audit activities to grow as they go - improving and advancing in expertise, quality, and overall professionalism as time passes. It also is important to point out that such an internal audit activity can comply with the Standards along its way to the next level of maturity.
While a Quality Assurance and Improvement Program is important for all internal audit activities, the development of a program is especially critical for newly established shops, as it provides a blueprint, based on the Standards, for a quality-oriented internal audit activity.

**STEPS TO “BEGINNING” QUALITY**

1. Adopt The IIA’s official definition of internal auditing.

2. Achieve the appropriate reporting relationships.

3. Make a commitment to quality. Demonstrate this commitment by developing a charter for the internal audit activity, defining the scope of work, and delineating areas for which it is accountable and responsible.

4. Engage senior management and the board. Set up meetings with them to learn about their needs and expectations, as well as share your mission and philosophy on quality. Use A Standard of Quality as a presentation to build awareness and understanding, and garner their support.

5. Begin to develop a structured Quality Assurance & Improvement Program (QA& IP) that covers all aspects of the IAA and monitors its effectiveness. The Standards and Practice Guides provide for the requirements and guidance related to the QA&IP.

6. Make sure appropriate board members receive the *Tone at the Top* newsletter, and has access to these corporate brochures, which feature the importance of internal audit quality:

   - What Does It Take to Be a Professional?
   - Internal Auditing - All in a Day’s Work
   - Internal Auditing - Adding Value across the Board
   - The Audit Committees - Purpose, Process, Professionalism
   - The Audit Committee - A Holistic View of Risk
   - The Audit Committee: Internal Audit Oversight

**LEVEL TWO -- EMERGING**

A LEVEL-TWO IAA has achieved partial conformance with the Standards on its Path to Quality. At this level of quality capability the IAA has begun to implement a Quality Assurance and Improvement Program with ongoing monitoring and periodic self-assessments and an external assessment. The CAE has performed a risk assessment of the IAA to determine which risks should be actively managed. Action plans are in place to achieve general conformance with the Standards and to manage risks to within acceptable boundaries. An appropriate first target for a LEVEL TWO IAA is
LEVEL THREE which is the minimal threshold on the PTQM and represents "Generally Conforms" with the Standards.

KEY MESSAGES

- The Quality Assurance and Improvement Program should include both ongoing monitoring and the use of periodic assessments of conformance with the Standards and the Code of Ethics.
- Self-assessments bring to light departmental strengths and things that are going well. They also identify areas in need of improvement, as well as send to management a message regarding the internal audit activity's commitment to quality improvement.
- Self-assessments should be performed by the CAE or under the direction of the CAE by competent in-house audit professionals or other persons within the organization with internal audit experience and understanding of the Standards.
- Documentation of a self-assessment should include thoughtful recommendations for improvement, as well as detailed plans for implementing improvements.
- The internal audit activity should present to the oversight body and senior management a report or presentation on the results of the self-assessment and steps for improvement.

STEPS TO "EMERGING" QUALITY

1. Get involved in the local IIA and/or industry group of internal auditors, actively network with other internal audit practitioners, and participate in QA training.

2. The CAE, if not already, should begin working toward earning appropriate professional certifications, including the Certified Internal Auditor (CIA).

3. Begin to implement a structured Quality Assurance & Improvement Program (QA& IP) that covers all aspects of the IAA and monitors its effectiveness. The Standards and Practice Guides provide for the requirements and guidance related to the QA& IP. Refer to The IIA’s Self-assessment Checklist. Also, refer to The IIA’s Quality Assessment Manual, 5th edition for a detailed description of the self-assessment process.

4. Assign members of the internal audit staff responsibility for internal monitoring. Information revealed by monitoring, interviews, workpapers, and a self-assessment should lead the CAE and internal QA team to conclusions regarding the internal audit activity’s conformance with the Standards, conformance to its charter, and other relevant criteria.

5. Elicit feedback from others in the self-assessment process. Although this is not mandatory, it is helpful, as are results from surveys used at the end of your audits.
Audit Customer (Client) Surveys can provide excellent feedback about the internal audit activity's effectiveness and potential opportunities for improvement. The survey of audit customers should precede the on-site work. To benchmark your clients’ ratings with those of other internal audit departments, refer to this Client Survey Historical Results (2001-2008) report.

Internal Audit Staff Surveys also are an efficient way to obtain information from your staff members. To benchmark your staff's ratings with those of other internal audit departments, refer to this Staff Survey Historical Results (2002-2008) report.

LEVEL THREE -- CONFORMING

A LEVEL-THREE IAA "Generally Conforms" to the Standards and this degree of conformance has been substantiated through its Quality Assurance and Improvement Program and by an external assessment or self-assessment with independent validation. LEVEL THREE is the threshold for quality capability of an IAA on the PTQM. There may be some areas of the Standards that the IAA should continue to focus on and action plans have been developed by the CAE and communicated to the Board and senior management in order to address areas of improvement. Risks that the IAA will not accomplish the requirements of its Charter are being managed to an acceptable level of residual risk. The IAA has sufficient resources and competency skills and is able to react to changes with the organization with risked-based audits. There is a focus on continuous improvement.

A LEVEL-THREE on the PTQM may represent an appropriate target quality capability maturity level for many IAA's. After all, recognition as "Generally Conforms" with the Standards represents a high degree of professional achievement and the IAA should be highly regarded by the CAE, the Board, senior management and the organization's stakeholders. Characteristic of some LEVEL-THREE IAA's are those with minimal change within the organization or industry/sector. In addition, IAA's of smaller or less-complex organizations, including some public companies, may be comfortable with this level of maturity.

The CAE of a LEVEL-THREE IAA may target a LEVEL-FOUR on the PTQM if there is a desire or requirement for the IAA to offer additional value to the organization or if there is anticipated change in the organization's risk which could be better addressed by an IAA with greater capability. For example, the CAE may see an opportunity for the IAA to have greater involvement in auditing the organization's governance and risk management processes and will take steps to train staff and take assignments to demonstrate competencies in these areas and thereby add value to the organization.

KEY MESSAGES

In order for an internal audit activity to represent that it complies with the Standards, it must undergo an external assessment at least once every five years.
The CAE generally leads the process of selecting an external assessor or independent validator with the full involvement and support of the board and senior management.

The board should be directly involved in the process, as well as, the determination of the assessment method to be used, the approach to be followed, and the overall cost. External assessments can be accomplished through the use of an independent reviewer or review team, including a peer review, or through a self-assessment with independent validation.

An external assessment provides evidence to the IIA's stakeholders that both the board and the internal audit activity are concerned about the success of an organization's internal controls, ethics, governance, and risk management processes.

An external assessment also builds stakeholder confidence by documenting management's commitment to quality and successful practices.

An external assessment evaluates conformance with the Standards, the efficiency and effectiveness of the internal audit activity, and the use of successful practices.

The Self-Assessment with Independent Validation (SAIV) process involves the completion and documentation of a rigorous internal audit activity self-assessment (See PTQM Level-2), which is reviewed and tested by a qualified and independent validator. The validator also conducts interviews with appropriate board members and several key members of senior management. The resulting report is shared with senior management and the board, and complies with the Standards.

External assessments can be conducted through peer reviews by internal auditors - all of whom must be qualified to conduct external QAs - from a pool of three or more different organizations.

When depending on a peer review in the government sector, it is preferable to use government auditors who are not "related" to or have any influence over the department under review, and that an independent validator be engaged to review and validate the peer review.

**STEPS TO "CONFORMING" QUALITY**

1. Work on obtaining an appropriate mix of professional designations (including the CIA) that demonstrate your activity's professionalism and competency.

2. Complete - by or under the supervision of the CAE - the preparation for independent validation using a "balanced scorecard" approach. A balanced scorecard serves as a tool to help translate strategy into operational terms, from four perspectives: financial goals, customer growth and retention, internal business processes, and innovation and growth. The scorecard should be balanced between external measures for shareholders and customers and internal measures for internal business processes, innovation, and growth; as well as between outcome measures and measures of future performance. The balanced scorecard will help you to gather specific information about your organization and internal audit staff so that you can identify potential strengths and opportunities for improvement.
Also, refer to The IIA's Quality Assessment Manual, 5th edition for more preparation tools, as well as a detailed description of the external assessment process.

3. Refer to the following criteria when seeking a qualified external assessor:

a. Honest and candid within the scope of confidentiality.

b. Objective - more interested in service and the public trust than personal gain and advantage; impartial, intellectually honest, free of conflicts of interest.

c. Independent - not associated with the organization in any way.

d. Experienced - has personal knowledge of conducting external QA's.

e. Competent - preferably, a certified internal auditor, well-versed in best practices; with a minimum of three years recent internal audit or related management-consulting experience.

4. Put into place a CAE-developed action plan, based on the findings and recommendations made by the external assessor, for addressing needed changes and continuous improvement, along with a timeline for implementation. This plan should be presented to senior management and the board.

**LEVEL FOUR -- LEVERAGING**

A LEVEL-FOUR IAA places a high level of emphasis on implementing best practices in conforming to the Standards. An external review team is the approach utilized for its external assessment and emphasis is focused on identifying and implementing best practices. LEVEL-FOUR quality capability receives a high level of support from the organization's senior management and board and results in an expanded assurance and consulting role for the IAA. This support is achieved through leveraging best practices in anticipating and reacting to changes within the organization. The IAA effectively manages its risks in the face of demands by and changing risks to the organization. A LEVEL-FOUR IAA attracts top talent and is a source of talent to the organization.

Characteristic of some LEVEL-FOUR IAA's are those with fast-paced changes within the organization or industry/sector. A LEVEL-FOUR on the PTQM also may be appropriate for IAA's of large and complex organizations.

The CAE of a LEVEL-FOUR IAA may target a LEVEL-FIVE on the PTQM if there is a desire or need to offer even more value to the organization or if there is anticipated change in the organization's risks which could be better addressed by an IAA with greater capability. For instance, the CAE may see an opportunity for the IAA to assist in elevating the organization to that of industry leader in the area of financial reporting, which can be best accomplished at the highest level of quality capability.
KEY MESSAGES

- Use of external assessors that have experience in the profession's best practices provides the CAE with the opportunity to identify changes needed to better leverage the IAA to provide added value to the organization.
- Effective risk management of the IAA’s risk profile demonstrates to senior management and the board that IAA can be effective in providing assurance and consulting services to the organization.
- The CAE’s ability to leverage his or her interaction with senior management and the board is important in providing opportunities for expanded roles for the IAA’s assurance and consulting activities.

STEPS TO “LEVERAGING” QUALITY

1. Ensure the CAE of your internal audit activity is a Certified internal Auditor (CIA).

2. Participating in the IIA’s Vision University is an excellent way for the CAE to network with other CAE’s and to learn through discussion and debate of common issues.

3. Review the Common Observations from External Quality Assessments and address similar areas in your internal audit activity that might be below the level of desired quality.

4. Use Internal Audit Activity Leading Practices as a model for your continued growth.

5. Download and modify the Sample Request for a Proposal for distribution when seeking external QA services from potential providers.

6. Contact The IIA at quality@theiia.org to report completion of your external QA, so that your organization’s name can be added to The IIA’s Web site list. Also, be sure to inform your audit customers about your external QA, both before and after it has been conducted. This practice sends a message that you are willing to undergo the same level of scrutiny that they go through when being audited and that you are taking steps to implement recommended improvements.

LEVEL FIVE -- LEADING

A LEVEL-FIVE IAA is an innovator of best practices which support continuous improvement across the organization and industry and in the organization's communities. At this level of quality capability, the CAE and his or her team are considered strategic partners with senior management. As such, the IAA is a highly regarded advisor on governance issues and enterprise risk management strategies. Auditors within the IAA are often recruited by the organization into leadership roles where they continue to add value, utilizing skills developed while in internal auditing. The IAA is regarded as leader within the internal auditing profession and is a strong supporter and gives back to the profession
through support of colleges and universities, the IIA Research Foundation, IIA international committees and local chapters.

A LEVEL-FIVE quality capability is within the reach of many IIA's. The path to quality that culminates with this high level of quality capability maturity requires significant commitment and hard work, but there are significant rewards with this accomplishment, including knowing that stakeholder expectations have been met or exceeded and leadership in the area of quality has resulted in elevating the profession of Internal Auditing.

KEY MESSAGES

Although the Standards set the bar for professional practice, organizations at this level are exceeding requirements of the profession and key stakeholders, by going beyond the minimum level of conformance. This indicates the very highest level of commitment and professionalism, not just that which is mandated. This internal audit activity has achieved organization-wide respect for demonstrating value in helping achieve organizational objectives, as well as serving as a resource for education, counsel, and recommendations for improvement. This also applies to the view of the internal audit activity held by senior management and the board. Typically, the CAE is a C-level (chief or top-level) member of senior management at this organization. The activity demonstrates an unrelenting commitment to growth, development, and improvement through a systematic and ongoing mentoring, training, and education of its staff members. Not only does the internal audit activity operate at the advanced level, but - due in part to the positive influence and diligence of the CAE - the audit committee of the board is exemplary in setting and adhering to its charter and following the organization’s code of ethics; monitoring, overseeing, and evaluating the duties and responsibilities of management, the internal audit activity, and the external auditors; and reporting to the full board and senior management all-important matters pertaining to the organization's controlling processes.

STEPS TO "INNOVATING" QUALITY

1. Acquire and maintain an appropriate mix of professional designations (including the CIA) that demonstrate your internal audit activity's professionalism and competency.

2. Regularly benchmark your progress, such as through The IIA's Global Audit Information Network (GAIN).

3. Chronicle your activity's advancement through the levels to the top, and make your story available to others through IIA Global Headquarters at PR@theiia.org. Also, serve as a model for continued growth by sharing your practices and tools for success with The IIA by contacting quality@theiia.org.

4. Serve on external QA teams, or participate in peer reviews.
5. Give back to the profession by mentoring lower-level internal audit activities through IIA affiliation, speaking at events, participating in research studies, and writing articles that are based upon professional knowledge, experience, and expertise.

Internal Auditing Activities are expected to add value to an organization. IAA’s can best demonstrate value to management, the board, and audit customers through conforming to the Standards and implementing the best practices of the profession. Get on the path to quality today and ensure the value your internal audit activity will bring to your organization and its varied stakeholders tomorrow.