Chapter 1
THE EVOLVING INTERNAL AUDIT LANDSCAPE

Standards Require Quality Assurance Focus

As the acknowledged leader of internal auditors worldwide, The IIA is pleased to provide this revision to its Quality Assessment Manual. This is the sixth revision to the series that began in 1984. Whether you are an internal auditor, a director or audit committee member, an outside stakeholder, an educator, or a student, this material will help heighten your understanding and appreciation of the internal audit process. More importantly, it will delineate the high standards in place to support practitioners as they diligently work to add value to their organizations.

This new edition addresses the changes from the update to The IIA’s Standards issued January 1, 2011. Additionally, changes were made within the tools to reduce duplication, improve content, and provide improved guidance.

Definition of Internal Auditing

*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 Business Focus of Internal Auditing

Risk management is a key responsibility of management. To achieve its business objectives, management should ensure that sound risk management processes are in place and functioning. Boards have an oversight role to determine that appropriate risk management processes are in place and that these processes are adequate and effective. Internal auditors should assist both management and the board by examining, evaluating, reporting, and recommending improvements on the adequacy and effectiveness of management’s risk processes. Management and the board are responsible for their organization’s risk management and control processes. However, internal auditors can assist the organization in identifying, evaluating, and implementing risk management methodologies and controls to address those risks.

In many enterprises, risk management is a key component for all business activities and management controls. This includes entities in both the public and private sectors that are not often thought of as
representing “business activities,” but where the management of risks, the maintenance of effective controls, and the establishment of accountability are essential to their success.

The bulk of an entity’s risks relate to selecting strategies and objectives, establishing operational goals and accountabilities, allocating funds among projects and business segments, minimizing exposures to loss of reputation or credibility, and making optimal use of technology to manage the entity. Consequently, the enhancement of internal auditing’s traditional assurance role in both financial and nonfinancial areas, as well as the expansion of its assessment, process improvement, and related consulting activities, are logical complements to that broad risk management framework. In line with the definition, internal auditing must broaden its framework of service to management, the board, and the entity’s other stakeholders.

Rarely are demands for professionalism, knowledge, integrity, and leadership more stringent than those placed on today’s internal auditors. Effective auditors serve as the organization’s corporate conscience, and they champion operational efficiency, internal control, and risk management. They also educate and make recommendations to management and the board of directors (and/or other governance oversight bodies) to support the organization in meeting its goals and objectives.

How does today’s internal auditor sort through what must be done to ensure the highest quality results and what should be done to achieve long-term effectiveness and professionalism? The professional internal audit practitioner adheres to the guidance set forth in The IIA’s Code of Ethics, Standards, and Practice Advisories; pursues and achieves individual certification; conducts internal quality assessments; and undergoes independent, external quality assessments to validate compliance. When these practices are followed routinely, they can lead to success for both auditors and the organizations they serve.

**A Guidance Framework**

As business processes have become more sophisticated and complicated, the internal audit profession also has evolved. Over the past few years, it became evident that structural enhancements were needed to reflect these changes to the profession and to guide practitioners and those whom they serve.

The IIA’s International Professional Practices Framework (IPPF), based on the definition for the profession and supported by the Code of Ethics, comprises mandatory, advisory, and practical guidance in the forms of Standards, Practice Advisories, Practice Guides, and Position Papers, respectively.

What makes adopting the IPPF so critical to the effective practice of internal audit and why is it so important to stakeholders? Because the scope of work performed by today’s practitioners is so broad and varied, there is an expanded need for clear and concise guidance that can be adopted and followed readily, regardless of the industry, audit specialty, or sector. The IPPF fills this need. It also brings additional value to management, organizational governance entities, investors, and all other stakeholders by prescribing practices that assess and ensure effectiveness throughout the organization. Here is a summary of the IPPF.
Mandatory Guidance

- **Ethics** and **Standards**. This includes the Definition of Internal Auditing, Code of Ethics and the Standards. Compliance with each of them is mandatory. All mandatory guidance is submitted for review by the entire profession through the exposure draft process and is considered to be essential for the professional practice of internal auditing.

Strongly Recommended Guidance

- **Practice Advisories**. Although not mandatory, Practice Advisories represent best approaches and clarifications endorsed by The IIA as ways to implement Standards. In part, Practice Advisories may help to interpret the Standards or to apply them in specific internal audit environments. While some Practice Advisories may be applicable to all internal auditors, others may be developed to meet the needs of a specific industry, a specific audit specialty, or a specific geographic area.

Reference I of this Quality Assessment Manual contains a summary of the guidance from the Practice Advisories related to quality assurance. These Practice Advisories are also available on The IIA’s Web site, www.theiia.org.

- **Practice Guides**. Detailed guidance for conducting internal audit activities. These include detailed processes and procedures, such as tools and techniques, programs, and step-by-step approaches, including examples of deliverables.

- **Position Papers**. These IIA statements assist a wide range of interested parties, including those not in the internal audit profession, in understanding significant governance, risk, or control issues, and in delineating related roles and responsibilities of internal auditing.
Standards

The Standards are divided into three categories: Attribute, Performance, and Implementation Standards. The Attribute Standards address the attributes of organizations and individuals performing internal audit services. The Performance Standards describe the nature of internal audit services and provide quality criteria against which the performance of these services can be measured. The Attribute and Performance Standards apply to all internal audit services. The Implementation Standards expand Attribute and Performance Standards to prescribe standards applicable in specific types of engagements across the broad spectrum of assurance and consulting services offered by internal auditors. These standards ultimately may deal with industry-specific, regional, or specialty types of audit services.

The seven standards pertaining to quality are as follows:

1300 — Quality Assurance and Improvement Program

The chief audit executive must develop and maintain a quality assurance and improvement program that covers all aspects of the internal audit activity.

Interpretation:

A quality assurance and improvement program is designed to enable an evaluation of the internal audit activity’s conformance with the Definition of Internal Auditing and the Standards and an evaluation of whether internal auditors apply the Code of Ethics. The program also assesses the efficiency and effectiveness of the internal audit activity and identifies opportunities for improvement.

- 1310 — Requirements of the Quality Assurance and Improvement Program

The quality assurance and improvement program must include both internal and external assessments.

- 1311 — Internal Assessments

Internal assessments must include:

- Ongoing monitoring of the performance of the internal audit activity; and
- Periodic reviews performed through self-assessment or by other persons within the organization with sufficient knowledge of internal audit practices.

Interpretation:

Ongoing monitoring is an integral part of the day-to-day supervision, review, and measurement of the internal audit activity. Ongoing monitoring is incorporated into the routine policies and practices used to manage the internal audit activity and uses processes, tools, and information considered necessary to evaluate conformance with the Definition of Internal Auditing, the Code of Ethics, and the Standards.
Periodic reviews are assessments conducted to evaluate conformance with the Definition of Internal Auditing, the Code of Ethics, and the Standards.

Sufficient knowledge of internal audit practices requires at least an understanding of all elements of the International Professional Practices Framework.

- **1312 — External Assessments**

  External assessments must be conducted at least once every five years by a qualified, independent reviewer or review team from outside the organization. The chief audit executive must discuss with the board:

  - The need for more frequent external assessments; and
  - The qualifications and independence of the external reviewer or review team, including potential conflict of interest.

  **Interpretation:**

  A qualified reviewer or review team demonstrates competence in two areas: the professional practice of internal auditing and the external assessment process. Competence can be demonstrated through a mixture of experience and theoretical learning. Experience gained in organizations of similar size, complexity, sector or industry, and technical issues is more valuable than less relevant experience. In the case of a review team, not all members of the team need to have all the competencies; it is the team as a whole that is qualified. The chief audit executive uses professional judgment when assessing whether a reviewer or review team demonstrates sufficient competence to be qualified.

  An independent reviewer or review team means not having either a real or an apparent conflict of interest and not being a part of, or under the control of, the organization to which the internal audit activity belongs.

- **1320 — Reporting on the Quality Assurance and Improvement Program**

  The chief audit executive must communicate the results of the quality assurance and improvement program to senior management and the board.

  **Interpretation:**

  The form, content, and frequency of communicating the results of the quality assurance and improvement program is established through discussions with senior management and the board and considers the responsibilities of the internal audit activity and chief audit executive as contained in the internal audit charter. To demonstrate conformance with the Definition of Internal Auditing, the Code of Ethics, and the Standards, the results of external and periodic internal assessments are communicated upon completion of such assessments and the results of ongoing monitoring are communicated at least annually. The results include the reviewer’s or review team’s assessment with respect to the degree of conformance.
• **1321 — Use of “Conforms with the International Standards for the Professional Practice of Internal Auditing”**

The chief audit executive may state that the internal audit activity conforms with the International Standards for the Professional Practice of Internal Auditing only if the results of the quality assurance and improvement program support this statement.

**Interpretation:**

The internal audit activity conform[s] with the Standards when it achieves the outcomes described in the Definition of Internal Auditing, Code of Ethics, and Standards. The results of the quality assurance and improvement program include the results of both internal and external assessments. All internal audit activities will have the results of internal assessments. Internal audit activities in existence for at least five years will also have the results of external assessments.

• **1322 — Disclosure of Nonconformance**

When nonconformance with the Definition of Internal Auditing, the Code of Ethics, or the Standards impacts the overall scope or operation of the internal audit activity, the chief audit executive must disclose the nonconformance and the impact to senior management and the board.

**Quality Assurance and Improvement Program**

As an organization grows, its operations undergo refinement, and its internal processes change and evolve, its quality monitoring process must keep pace. To ensure consistent quality in this dynamic environment, an ongoing commitment to growth and improvement is essential.

The required elements of the program are periodic internal and external quality assessments, ongoing internal monitoring, and assurance that the IA activity complies with the Standards and Code of Ethics.

**Internal Quality Assessment**

According to the Standards, the quality assessment (QA) process should include both internal and external assessments. Internal assessments comprise ongoing internal evaluations of the IA activity, coupled with periodic self-assessments and/or reviews. These internal assessments are conducted by persons within the organization’s IA activity under the direction of the chief audit executive (CAE). Involvement, however, precludes total objectivity.

As outlined in the Standards, internal assessments must include:

1. Ongoing monitoring of the performance of the internal audit activity; and

2. Periodic reviews performed through self-assessment or by other persons within the organization with sufficient knowledge of internal audit practices.
External Quality Assessment

External assessments require an outside team of independent reviewers to evaluate compliance with the Standards, the use of successful practices, and the efficiency and effectiveness of the IA activity.

The purposes of the external quality assessment are to:

1. Assess the effectiveness of an IA activity in providing assurance and consulting services to the board, senior executives, and other interested parties.

2. Assess conformance to the Standards and provide an opinion as to whether the IA activity generally conforms to all of the standards.

3. Identify opportunities, offer recommendations for improvement, and provide counsel to the CAE and staff for improving their performance and services and promoting the image and credibility of the internal audit function.

Framework of External Quality Assessment Activities

The framework within which a business-focused external QA is conducted is conceptual, without hard and fast parameters within which its nature and boundaries are defined. It consists of two parts.

The first part of the QA framework includes the major groups involved in the governance process within an organization. There are four major groups involved in this process:

1. The Oversight group comprises the board of directors and its various committees or legislative and other oversight groups in government and not-for-profit settings. The focus of the QA on this group is the role and expectations of the oversight group.

2. The Stewardship group comprises executive management. This group has a dual role of stewardship (of resources allocated by the board) and accountability for the results of operations of the entire organization.

3. The Performance group consists of operating and support management and staff. Its role is primarily that of delivering goods and services at expected levels of cost within the time and resources allocated by executive management.

4. The Assurance group’s role is to provide independent and objective assurance to the first three groups, as well as advice and assistance to enhance the organization’s effectiveness.

The primary tasks, responsibilities, objectives, and relationships of the four groups are discussed in further detail in Reference II.

Internal audit is identified as one of the functions within the assurance group. It plays a pivotal role with the other three major groups involved in the governance process in that its primary mission is to:
(a) provide assurance to them that the controlling processes in the organization are adequately designed and functioning effectively, and (b) where appropriate, offer recommendations and counsel to directors and managers to improve their performance.

The second part of the QA framework focuses on the ingredients of managing an IA activity. These ingredients include:

1. A policy statement on controlling the organization’s activities.
2. The charter of the IA activity, which has as its genesis the policy statement.
3. The control environment of the audit practice and the influence of the CAE.
4. The IA activity’s ability to add value to the enterprise.
5. Assurance that the IA activity focuses on enterprise risk management, control, and governance processes and aligns its audit plans to the objectives of the larger enterprise.
6. Relevant practices of successful auditing activities compiled by The IIA.

**Scope of the External QA**

In this Quality Assessment Manual, the scope of the external QA has been expanded beyond determining whether the IA activity conforms to the Standards and its own charter, plans, policies, and procedures. The expanded approach encompasses the role and relationships of the IA activity in the entity’s governance process and the processes adopted for managing the internal audit practice and resources.

The scope includes the following key elements of professional internal audit practice:

1. The expectations of the IA activity expressed by the oversight group, executive management, and its other “customers” (i.e., management of operational and support units).
2. The entity’s control environment and the CAE’s audit practice environment.
3. The focus on evaluating enterprise risk, assessing organizational controls, and including aspects of the governance process in audit plans to assure that audit activities add value to the enterprise.
4. The integration of internal auditing into the organization’s governance process, including the attendant relationships and communications between and among the key groups involved in that process and aligning audit objectives and plans with the strategic objectives of the entity as a whole.
5. The *Standards*.

6. The mix of knowledge, experience, and disciplines among the staff, including staff focus on process improvement and value-added activities.

7. The tools and techniques employed by the department, with emphasis on the use of technology.

These elements are applied with considerable flexibility, and bearing in mind all of the other elements of governance and management control discussed in this chapter. The most important consideration is to ensure that, while the reviewers bring their independence and objectivity to the work, the external QA is tailored to the particular needs and desires of the CAE, senior management, and the board.