

10 Key Internal Audit Topics for Audit Committee Consideration

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Introduction

One of an audit committee's most important responsibilities is to oversee the organization's internal audit function, which plays a major role in the areas of risk management and corporate governance. Typically, a Chief Audit Executive, or CAE, will have a direct reporting line to the audit committee, which has functional oversight of internal audit activities. To assist audit committees with this oversight, and to provide a strategic framework for the direction and orientation of internal audit, the authors outline 10 suggested topics for discussion between the CAE and the audit committee. These topics, framed as questions, stem from the results of the largest-ever global survey of internal auditors, which identified 10 "imperatives" for internal audit focus.

Every five years, the Institute of Internal Auditors (the "IIA") conducts its Global Internal Audit Survey to gain a current snapshot of the profession. The IIA's most recent survey included responses from more than 13,000 internal auditors around the world. During 2011, the Institute of Internal Auditors Research Foundation (IIARF) published a series of reports to discuss the results of the global survey. One report, *"The Global Internal Audit Survey, Imperatives for Change: The IIA's Global Internal Audit Survey in Action,"* used

the data as a springboard to take a forward look at the profession and suggest 10 areas for scrutiny and focus in the years ahead.

Although developed for internal auditors, the *Imperatives for Change* report also suggests a roadmap of important topics for joint consideration by the audit committee and chief audit executive. They also point to the linkages between topics and the need to consider the implications of their interrelationships.

10 Key Questions for Audit Committees

Outlined below are the 10 imperative topics for internal auditors recast into rhetorical questions for audit committees. Each question is followed by a short discussion of the topic, examples of related internal audit activities, and additional topics and/or questions for audit committee consideration.

Q1: What is the internal audit coverage of the organization's risk management and governance processes?

In recent years, internal auditors have been increasing their focus on the risk management and governance processes of the organizations they audit and assess. At the same time, audit committees have stepped up their interest in risk management and governance, reflecting the heightened oversight of these areas on the parts of regulatory and supervisory bodies in both the public and private sector. Given the



Guidance from the Board of Governors of the Federal Reserve System on the relationship between the risk assessment and the audit plan

“Risk assessments should be revised in light of changing market conditions, or laws and regulations and updated during the year as changes are identified in the business activities of the institution or observed in the markets in which the institution operates, but no less than annually. When the risk assessment indicates a change in risk, the audit plan should be reviewed to determine whether the planned audit coverage should be increased or decreased to address the revised assessment of risk.”

Supplemental Policy on the Internal Audit Function and It's Outsourcing, January 23, 2013

importance of these areas, the audit committee needs to evaluate the current and projected scope of internal audit coverage of risk management and governance .

In organizations in the initial stages of risk management implementation, the role of internal audit is often that of a catalyst or facilitator to help foster development of the organization's risk management processes. In such situations, internal auditors' knowledge of the organization and its risks can be very helpful. And as the organization's risk management processes mature, internal audit can serve in more of an assurance capacity, providing audit coverage of the risk practices that have been implemented.

On a similar note, internal audit also can provide advice and assurance over the organization's governance processes. Of note, the IIA's *International Standards for the Professional Practice of Internal Auditing* (the "Standards") now require internal auditors to address both risk management and governance processes in their audit coverage.

Q2: How responsive to change and flexible is internal audit's risk-based audit plan?

Internal auditors are required by the Standards to conduct a risk-based audit plan. While there is no one approach to conducting risk assessments and developing the related audit plan, many internal audit groups conduct an annual risk assessment and prepare an annual audit plan. In today's world of complex and dynamic risks, however, more and more internal audit groups are updating their risk assessments and audit plans on a more frequent and timely basis than just annually. For example, survey results indicate that it is becoming more common for internal auditors to update their audit plans on a quarterly basis. What's more, a number of internal audit groups have moved to "rolling" audit plans of that only cover six-month periods. By taking a more timely approach to their audit planning, organizations are helping to ensure that their audit coverage is focused at the most critical issues in a given time period.

The audit committee needs to understand how, and with what frequency, internal audit updates

their risk assessment and how responsive and flexible they are with their audit plans. In addition to recommended changes to the audit plan, the audit committee needs to ensure that internal audit provides it with a rundown on changes to the organization's risk profile or new emerging risks that are driving audit plan changes. By reviewing changes to the organization's risk profile, the audit committee can gain comfort that the recommended audit plan changes will address current risks.

One further point: The audit committee should have a clear understanding that the CAE's role extends beyond audit plan execution to ensure that the internal audit process is identifying changes to the organization's risks and addressing these risks on a timely basis.

Q3: How does internal audit use technology to enhance its auditing and monitoring activities?

Technology tools are increasingly being used by internal auditors to enhance both the efficiency and effectiveness of their auditing activities. For example, powerful data mining tools enable internal auditors to perform audit tests on entire populations of data as opposed to testing data samples alone. In addition, data mining tools enable internal auditors to monitor controls, risk and fraud indicators, and performance metrics. Given the scope of these capabilities, many internal auditors find that such tools offer significant opportunities to improve and enhance their auditing efforts.

Audit committees need to determine how their internal auditors are using technology, their plans for leveraging technology further, and what types of support the internal audit function needs to be successful. To make these determinations, the audit committee also needs to be aware of the specialized skills and budgetary support required by internal audit to achieve its technology objectives. These are all topics of possible inquiry by the audit committee.

Q4: What is the strategic vision and plan for internal audit?

With the rapid changes in commerce today, strategic planning has taken a new and elevated

focus in many organizations. Internal auditing is no different. For internal auditors to keep current with new developments in auditing, technology and business, they must plan effectively. As the IIA Global Survey indicates, “A well-conducted strategic planning exercise will allow the CAE to develop his or her mission and various approaches and strategies to achieving that mission.”

To assess the strategic orientation of their internal audit functions, audit committees should ask questions such as these:

- What is internal audit’s vision for the near- and mid-term future?
- Does internal audit have a strategic plan?
- How does internal audit plan to keep pace with the risks and processes in the business?
- Has internal audit identified gaps between where its processes and practices are today and where they need to be in the 3-5 years?
- Does the internal audit strategy align with and support the organization’s strategic plans?

The IIA’s Global Internal Audit Survey in Action - The need to develop strategies and actions to meet stakeholder expectations

To deal appropriately in a demanding operating environment, it is vital that the CAE, in concert with both the audit committee and senior management, achieve agreement on the specific areas of focus for the internal audit activity. It is also imperative for the CAE to determine the specific expectations of his or her chief stakeholders and to develop strategies and tactics to address these expectations. Moreover, it is critical to monitor stakeholder feedback in an ongoing, systematic manner and to update internal audit plans as needed to address changing expectations.

Q5: What perceived value does the organization receive from its internal audit activities?

According to the definition of internal auditing promulgated by the IIA, internal auditing activities are designed to “add value” to an organization. How an internal audit function goes about adding value differs from one organization to another, depending on the expectations of internal audit’s key stakeholders. Thus the challenge for audit committees and internal auditors alike is to define

clearly what those expectations for adding value are and then to tailor their processes to meet those expectations. .

For any internal audit function, providing assurance is a core and expected value driver. But what other types of value do stakeholders expect internal audit to provide? For example, some internal auditors today add value by providing high quality talent to their organizations. Others assist management by providing monitoring and data mining capabilities that contribute to improved business-unit performance, or assist in enhancing risk management and governance processes.

Irrespective of the specific value drivers of an organization, however, there should be clarity and agreement among internal audit, executive management and the audit committee as to stakeholder expectations and the specific internal audit activities to which stakeholders ascribe value. It’s then up to internal audit to address those expectations and value drivers and assess how well it is doing so. By operating in this manner, stakeholder perceptions become real and tangible and increase the likelihood that internal audit will deliver sought-after value.

Q6: How do we strengthen communications and relationships between internal audit and the audit committee?

Ideally, the relationship between internal audit and the audit committee will be characterized by open communications, respect and trust. To achieve and maintain such a relationship demands ongoing attention by both parties. For their part, members of the audit committee should continually ask themselves how they might enhance their relationship with internal audit, particularly with regard to informal communications.

One way to enhance audit committee/ CAE relationships is joint training involving the audit committee chair and chief audit executive. In another example of effective relationship building, a CAE’s direct reports meet periodically with the audit committee chair and are invited to make presentations to the audit committee. Such interactions



provide opportunities for the audit committee to see key members of the internal audit staff in action, a factor contributing to effective succession planning for the CAE.

Q7: How does internal audit ensure that its activities are in full compliance with “The International Standards for the Professional Practice of Internal Auditing?”

The IIA is the global standards-setting body for the internal audit profession. In this capacity, the IIA promulgates *The International Standards for the Professional Practice of Internal Auditing* (the “Standards”).

Most internal audit functions have charters stating that internal audit conducts its activities in accordance with these Standards. In the same manner that the audit committee expects its external auditors to comply fully with their professional standards, it should also expect its internal auditors to comply fully with their Standards. To this end, the audit committee should request periodic confirmation from their internal auditors that they do, indeed, comply fully with the IIA Standards.

Of note, the IIA Standards require an external assessment of the internal audit function at least every five years. The audit committee should ensure that this requirement is met and that it receives the report from the external reviewer.

Q8: How does internal audit acquire and develop top talent for the organization?

The quality of an organization’s internal audit function is heavily dependent on the quality of its people. This is especially true today where the amount of change and complexity of risks facing most organizations create significant and varying challenges. Traditional auditing and accounting skills remain highly valued in today’s environment, but must be augmented with non-traditional auditing skills. Data-mining specialists and staff with in-depth industry knowledge are just two types of talent being sought after by today’s internal audit functions.

A true measure of internal audit staff quality is the degree to which the internal audit function is perceived to be a source of talent for other

parts of the organization. Some companies have formal rotational programs wherein highly talented staff members are assigned to internal audit for a specific time period to gain valuable experience that can then be taken back to the business units. At other organizations, members of the internal audit staff are recruited by other organizational entities because of their in-depth knowledge of the business and its risks and controls. It is important for audit committees to be aware of the role that internal audit either is playing or *could be* playing to address the broader talent needs of the organization.

Q9: What types and levels of training necessary for internal audit to accomplish its mission?

For internal auditors to keep pace with the dynamic changes in business, technology and risk today, they must have access to continuous, current and robust training. An effective training program needs to go beyond basic accounting or auditing skills to address critical areas such as data mining and analysis, risk management, governance processes, new-product marketing and new technological applications. Softer skills – such as how to make good decisions, how to interview effectively, and how to think critically – also need to be stressed. In particular, the audit committee should inquire as to whether the training is adequately equipping the internal audit staff to conduct auditing activities appropriate for the organization’s current and evolving risk profile.

Q10. Does internal audit periodically inventory and assess its skills to identify gaps and, if so, how are they being addressed?

The dynamic nature of organization’s and their risks places a continuing demand on internal audit to periodically assess its skills inventory. In addition to audit and accounting capabilities, the organization’s risks may drive needs for specialists in languages, social media, data security, mathematics and beyond. In this environment, most internal audit functions will experience some sort of skills gap from time to time. When they do so, they are increasingly turning to third parties to supply needed skills on an “as needed” basis.



Audit committees need to have a critical discussion of skills with their internal audit leadership. In posing questions to the CAE and senior auditors, the audit committee should start with the internal audit risk assessment, not the audit plan. The central question: Has internal audit identified all the skills needed to address the organization's risk profile and where does it stand relative to acquiring those needed skills? The audit committee should encourage the CAE to consider various approaches to addressing those needs, including third parties as well as tapping corporate resources outside of internal audit to address particular needs.

The primary concern is that internal audit has the breadth of skills necessary to provide coverage and assurance over the organization's control and risk management processes. This is an issue that can be particularly critical to small- and medium-sized internal audit functions that lack the size or budget to have in-house access to the broad range of skills needed to address their changing risk profiles.

Conclusion

The 10 topics of discussion listed above can form a useful framework for in-depth discussions between an audit committee or audit committee chair and their chief audit executive. Such discussions can help both parties come to a better understanding and agreement on where their internal audit function stands relative to the profession and point to needed areas of

focus moving forward. Audit committees are encouraged to take advantage of the discussions above in seeking to gain additional insight on the quality and direction of the internal auditing activities being conducted under their oversight.

List the 10 questions

1. What is the internal audit coverage of the organization's risk management and governance processes?
2. How responsive to change and flexible is internal audit's risk-based audit plan?
3. How does internal audit use technology to enhance its auditing and monitoring activities?
4. What is the strategic vision and plan for internal audit?
5. What perceived value does the organization receive from its internal audit activities?
6. How do we strengthen communications and relationships between internal audit and the audit committee?
7. How does internal audit ensure that its activities are in full compliance with "The International Standards for the Professional Practice of Internal Auditing?"
8. How does internal audit acquire and develop top talent for the organization?
9. What types and levels of training are conducted by internal audit?
10. Does internal audit have skill or staffing gaps and, if so, how are they being addressed?

Author's Bio

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