National Audit Office

Chartered Institute of Internal Auditors

Internal Audit in Practice

A series of case studies produced in collaboration with the National Audit Office, featuring public and private sector organisations

Foreword

The drive for greater efficiency in public spending and the more localised delivery of services is changing the focus of government. As a result, the risks are changing and the governance, risk management, internal controls and assurance processes need to adapt.

Internal audit's role in this is essential both in providing assurance on the effectiveness of controls over key systems and in advising executive management and those responsible for governance on the management of risk. These are not easy tasks when resources are stretched and increasing demands are made of internal audit by departmental boards enhanced by highly experienced non-executive board members with commercial backgrounds.

But the profession can reach new levels of influence and recognition as it responds to the challenges it faces.

This series of case studies is designed to support that response. Arranged under six themes common to all internal audit teams, they draw on interviews with private and public sector heads of internal audit, who explain their approaches to the challenges of, for example, building relationships with audit committees, evaluating the impact of internal audit and undertaking a risk based approach to internal audit.

The examples are not necessarily meant to represent best practice but are intended to showcase a range of responses to the demands placed upon internal auditors.

We hope they will be a valuable tool to promote new ideas and support the development of your internal audit function.

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Applying internal audit resources

Internal audit needs to make sure that the resources it has are sufficient to meet the expectations of the audit committee. This requires careful planning and a realistic view of the budget and skills that the audit function has.

Telecoms provider BT's director of internal audit and enterprise risk management James Grigor sets out how he ensures the function's activities are properly resourced

British Telecom (BT) is the UK's largest communications service company. It has an annual revenue of £20bn and employs over 90,000 people, with customers in more than 170 countries. Over 60% of Fortune 500 companies including Google, Microsoft and Pepsi use BT's networked IT services.

James Grigor joined BT as director of internal audit in 2007. He has a team of 67 internal auditors who are all based in the UK. They carry out operational audits and review work primarily in the UK, Europe, and North America, while Big Four accountancy firm Ernst & Young performs much of the internal audit work for the group's operations in Latin America, Middle East and Africa, and Asia Pacific through three regionally based co-sourcing agreements. These reviews are overseen by BT internal audit and follow the same methodology that the function employs in all its reviews. Over the past five years the number of BT internal auditors has reduced slightly, though the use of co-sourcing has risen.

Two years ago BT's internal audit department changed its operating structure. Previously, the internal audit function had been aligned "vertically" with each of BT's six lines of business (Openreach, Retail, Global Services, Wholesale, BT Innovate and Design, and BT Operate). This meant that the function was effectively split into six different sections so that there was a dedicated – and separate – internal audit team for each of these business areas, plus a

> "It would be impossible to allocate internal audit resources to every project in BT" – James Grigor, BT

finance team and a general internal audit team that carried out reviews across the group.

A potential problem with such an approach was that internal audit's expertise could become "siloed", meaning that operational expertise and key skills were not being shared between the different internal audit teams. It also meant that work was being duplicated, and resources were being mis-spent.

Grigor rearranged the internal audit function's structure so that it was aligned "horizontally" across the organisation. For example, the same internal audit team now conducts all reviews of billing systems in any of the lines of business: in the past this would have involved several teams each reviewing their own discrete area.

Grigor has also overhauled the function's "audit universe" to provide a clearer idea of each of the auditable entities that internal audit should be covering and the extent of coverage, as well as risks that may be emerging. Grigor found that due to the way it had been designed and maintained, the previous audit universe was not working effectively, had become unwieldy, and had a lot of duplication of work.

"BT had been through a major acquisition drive in the decade before I joined, and internal audit had not kept pace with all the overseas assets that the company had bought. As a result, audit coverage in some areas was not good enough," says Grigor.

"We didn't seem to have an overall perspective of what entities needed reviewing, what their prioritisation should be, and what the emerging risks were. Since reviewing our audit universe we have found that we have identified around 600 entities – before the review, due to duplication, it was 6,000," says Grigor.

According to Grigor, the re-organisation of the internal audit function has improved coverage and led to a better use of resources, even with a slightly reduced headcount.

Given the global reach of BT's activities, its six lines of business, and the number of projects that the group is involved in, the internal audit function's resources have to be budgeted and accounted for carefully. "It would be impossible to allocate internal audit resources to every project in BT," says Grigor. "Instead, we audit the overarching processes for the delivery systems and check the over-riding governance behind these decision-making processes rather than attempt to review the execution of each individual project," he adds.

Practical advice for applying internal audit's resources

1 Ensure that the internal audit function has the right development practices and the right mix of people – headcount is just a number.

2 Ensure that sound recruitment processes for the internal audit team are in place. Be clear about the skills that are required and that the people recruited have them: recruitment is the most important management activity that any head of internal audit will carry out.

3 Equip the people in the function with the right tools to do the job. Are they working efficiently and effectively? What controls and procedures are in place to check?

4 Minimise areas of duplication in the work that internal audit does, as well as other assurance providers to the business.

5 Learn from the best practices being used by external or other assurance providers, such as external consultants and the Big Four accounting firms.

6 Internal audit must check its own performance as well as the departments it audits: is the feedback from customers and stakeholders good? Does the executive team value internal audit's contribution? How is feedback monitored, measured and reported?

Budgeting work days

Internal audit's work – which follows a risk-based approach – is planned annually and is subject to quarterly review. This allows Grigor to review the audit plan and to re-balance resources if necessary, including additional co-sourcing arrangements.

Presently, 54% of the function's time is aligned with the organisation's key risks. Of that, around 20% of internal audit's budgeted days are spent on reviewing financial, governance and regulatory risks: 15% of the function's allocated days is spent looking at contract management and how customer complaints and delivery failures are dealt with, and controls preventing information security breaches and service interruption.

Compliance with the US Sarbanes-Oxley Act (SOX) – which aims to improve corporate governance and foster better internal control and which is a regulatory requirement for companies with a US-listing – remains a key area for internal audit: about 10% of

the function's resource is spent on SOX reviews, and that is unlikely to decrease.

A significant focus of BT's internal audit resource strategy is devoted to training and development. "When I joined BT in 2007 the internal audit team was largely made up of 'generalists' with around one quarter of the team holding a professional qualification. Since then, we have established a strong IT and technology capability and a strong finance team. We have made a firm commitment to train and upskill our people: presently, 60% of the team have professional qualifications in either internal auditing (Chartered Institute of Internal Auditors), or IT or accountancy," says Grigor.

The investment in training means that it is quite rare that the internal audit function requires a skillset that it does not have in-house. "If we need other expertise, then we will look for it inside the business first or buy it in from one of our co-sourcers," says Grigor.

"We have not historically seconded internal auditors and put them into the business to learn skills: the opportunity for such short-term roles does not often arise. However, we see increasing numbers of our team moving into permanent roles elsewhere within BT where their risk and control disciplines can be used to great effect," he says.

Assurance vs consultancy

In recent years the internal audit function has been asked to provide assurance

Useful professional guidance

The general principles regarding what resources are needed and how to apply them are set out in Standard 2030: Resource Management in the *International Standards for the Professional Practice of Internal Auditing* (**http://bit.ly/LxMI9A**).

Practice Advisory 2030-1 states that the level of resource should be related to the nature and extent of assurance the audit committee and senior managers want (**http://bit.ly/K7NMNh**).

The Chartered Institute of Internal Auditors' professional qualifications also highlight issues surrounding assurance needs and consultancy services, as does its learning materials. For example, *M3 Learning Text – Topic 8 (on internal audit's varied roles)* – includes a section on the scope of consultancy work.

Visit **www.iia.org.uk** for more information, including the "Knowledge Centre", which contains a wide range of resources on risk management and internal auditing.

> "It is important to understand how internal audit functions in other organisations operate, including how they apply their resources, so that we can learn from their best practices" – James Grigor, BT

on a wider range of risks and business areas as the executive team has realised the value of the work it carries out.

However – with the agreement of the audit committee – Grigor says that the function's primary role is to serve the business as assurance providers; any consultancy work that internal audit carries out is secondary to its core focus.

"We have three criteria that need to be satisfied if we are going to carry out consultancy work," says Grigor. "Firstly, the work we are being asked to do needs to materially impact the business. Secondly, we must have the skills within the team to be able to carry out the work. And thirdly, we must be able to have the time to do the work without jeopardising our activities in the core assurance programme," he adds.

Grigor says that the key to maximising one's resources properly is about using the skills of the team rather than just following an approach. He also says that it is also important that the internal audit team learns from its own experience; not just from changes or challenges team members have faced in BT, but from the organisations where they were previously employed and the best practices that they adopted there.

It is also important to learn from external sources, says Grigor. This can include the practices that the Big Four accountancy firms carry out, professional guidance issued by the Chartered Institute of Internal Auditors and other bodies, as well as presentations given by other heads of internal audit at conferences. BT's internal audit function has a Practice Office of five people that regularly reviews best practice in its own operations, but also reviews what other internal audit departments and external assurers are doing, as well as ensuring that the guidance and standards of the CIIA are observed. This team also undertakes the quality assurance review of the internal audit team's own output.

"It is important to understand how internal audit functions in other organisations operate, including how they apply their resources, so that we can learn from their best practices. This will help foster a culture of continuous improvement," says Grigor.

Scope of internal audit

Internal audit's work is defined by the range of risks identified. Heads of internal audit need an effective process to define their scope of work.

How should internal audit ensure adequate coverage of risk and internal control within the organisation? The following case studies show how some organisations define the function's scope

Jonathan Kidd, head of internal audit, Met Office

Based entirely in Exeter, the Met Office internal audit team has seven staff, including the head of internal audit, Jonathan Kidd, who joined in January 2012. The function is split equally into a team of three lead auditors and three junior auditors. Two of the team have IT audit qualifications.

The function follows a risk-based internal audit approach. Internal audit carries out reviews of governance, risk management and internal control across the organisation as the main part of its audit work, but also conducts bespoke work such as supporting fraud investigations and consultancy.

"The internal audit team takes an overall view of the risk and assurance landscape," says Kidd. "We look at the risks in key areas against corporate objectives and the risk appetite of management with these risks," he adds.

The Met Office internal audit function discusses with management the categorisation of proposed audits on an "ABC" model from high to low risk. The function also uses assurance mapping to see what gaps in assurance – if any – are present and which assurance provider should be responsible for reviewing the management of the risk.

"We look at existing assurance that is being provided to management from other assurance providers and consider how reliable it is. We review the risks that they are

"The scope of internal audit's work is defined by the risks identified and prioritised by senior management and the audit committee, which forms the basis of the audit plan" – Jonathan Kidd, Met Office

responsible for and determine what is risk-based and what level of assurance they provide and how they understand risk," says Kidd.

"We determine whether all these assurance providers share the same view of risk and whether their appreciation of key risks is aligned. We also review how well senior management is managing risk to make sure that they also appreciate and understand risk in the same way," he adds.

Kidd says that the scope of internal audit's work is defined by the risks identified and prioritised by senior management and the audit committee, which forms the basis of the audit plan. The Met Office's risk management team then manages those risks, while internal audit liaises with the team to suggest controls and to review progress.

The internal audit function also operates a "rolling plan" of audits that may be considered for review. Kidd says that this is a way of constantly refreshing the audit programme to ensure that the audit committee and management are kept aware of emerging risks and that assurance is continually focused on the most important risks to the business.

"The 'rolling plan' is a working document that sits in the background throughout the year," says Kidd. "If there is a risk area that is coming to light or we get a request to review then it goes on the rolling plan. We then categorise these audits for possible review depending on how highly management prioritise risks related to them."

"We speak to people across the business individually to validate whether risk registers are accurate and whether they reflect the key areas of risk that they face within their business areas," says Kidd. "It is not just an annual process: we constantly have a 'watching brief' to see if there are any emerging risks that we need to be aware of and to budget for in any future audit plan," he adds.

Practical advice on how to scope internal audit's work

1 Agree the scope of internal audit's work with the audit committee and have it built into the audit charter, but try to leave a degree of flexibility so that the function can react to emerging risks that become a priority.

2 Look at the range and depth of assurance that is being provided to management from other assurance providers within the organisation: this will reduce duplication and free up resources to provide deeper assurance in other areas.

3 Make sure that internal audit's work is aligned to management's view of risk: the function may be focussing on the wrong issues if it does not understand management's risk priorities.

Kidd's team conducts a wide-range of audits – some of which are highly specialist, such as reviewing how the Met Office manages its ongoing response to volcanic ash-related requirements – and so requires either sufficient expertise in-house, or to source those skills from an external provider.

"Fortunately, we do have a lot of specialist skills in-house, and we can source expertise from within the business if we need to, as well as tap the skills of our external assurance providers. However, this requires planning: we always need to keep some of our resource unallocated in case we are asked to provide assurance on risks that suddenly become very important. Asking for further resources outside the budget depends on a strong business case, " he says.

Scope of internal audit

David Finch, director of group business risk and assurance, Travis Perkins

Travis Perkins is a FTSE listed company and is a main supplier to the UK building and construction market. With a turnover of £4.8bn, the company operates through 13 business units and has nearly 2,000 branches. The internal audit team is split into three sections: operational audit work (17 staff), corporate audit (5), with a further 4 staff carrying out specialist audit work, such as managing third party contracts.

The scope of internal audit's work is set out in the audit charter that defines what the function can and cannot do. This is agreed and ratified annually by the audit committee and provides a "go anywhere, look at anything" remit to the function. To ensure that internal audit is truly independent of the pressures of management, Finch can only be appointed or dismissed by the PLC board.

"If internal audit is going to sit independently then it is best to set the charter and terms of reference as wide as possible. Doing so sets a remit for internal audit to look at any activity in any of the group's businesses anywhere in the world. Having a wide remit in the audit charter allows us the freedom to do what we think is right for the role of internal audit," he says.

Following discussions with Finch, Travis Perkins' audit committee recognises that around 40% of the audit programme will contain a financial bias, with the remaining 60% being non-financial in nature. This diversity places certain resourcing pressures on the function, and as a consequence, the skills within the team are diverse. In addition, the head of internal audit has the authority to use external resources where a topic is complex and beyond the skills of the in-house team.

Finch says that there are around 200 business risks on the corporate risk register, ranging from "general" to "specialist" to unpredictable "black swan" risks. These are prioritised using a risk-scoring matrix. Finch adds that he deliberately does not account for 100% of internal audit's work in the audit plan. Instead, he leaves a "contingency" so that the function has appropriate resource if an audit review will take more time or needs more people. Management can request unplanned projects to be executed, but the head of internal audit also has the ability to instigate projects based on areas of concern.

"We plan about 90% of our budgeted days for operational audit work and leave

> “If internal audit is going to sit independently then it is best to set the charter and terms as reference as wide as possible” – David Finch, Travis Perkins

10% unplanned. For corporate and specialist audit work we plan about 75% of our work and leave around 25% unplanned. This gives us plenty of leeway if a review takes longer than expected, or if we feel that we need to review an emerging risk area that was not originally on the audit plan,” says Finch.

“There is nothing worse than going back to the audit committee after agreeing the audit plan for the year to say that you need to change the number of risk reviews and increase the budget. It shakes their confidence. It is far better to leave some resource unallocated so that you can inform the audit committee that a new risk has emerged, but that you have the resources already to review it,” says Finch.

“If we need more money to outsource more audit activities, buy in specialist skills, or carry out unplanned work then I go direct to the finance director to ask for the funds. The reality is that you can’t plan for every problem that may emerge in the 12 months ahead: the organisation needs to be flexible, and internal audit needs to be able to state the full business case to set out why the extra cash is necessary.”

Useful professional guidance

The *International Standards for the Professional Practice of Internal Auditing* and associated Practice Advisories provide useful guidance on defining internal audit’s scope. Practice Advisory 2050-2 focusses on assurance mapping. Standard 1000 and Practice Advisory 1000-1 (**http://bit.ly/JNjK4R**) relate to purpose, authority and responsibility and require internal audit to set these out in a charter.

The series of Standards and Practice advisories of Governance (2110-3) (**http://bit.ly/KuRRrT**), Risk Management (2120-1) (**http://bit.ly/LxPc7S**), and Control (2130-1) (**http://bit.ly/MgHsDH**) give useful detail on the scope of internal audit.

The Chartered Institute of Internal Auditors has published several other guidance-related resources, including one on how to audit organisational strategy (**http://bit.ly/Jalf7d**) and a good governance checklist (**http://bit.ly/JkLYml**). It has also published guidance on providing ethical assurance to boards (**http://bit.ly/JlaYXe**).

Its professional qualifications also address the issue. *M3 Learning Text – Topic 9 (IPPF and internal audit tools, techniques and complex assignments)* – addresses ethical audits and reviewing board effectiveness.

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Scope of internal audit

Bruce Vincent, global head of internal audit, InterContinental Hotels Group (IHG)

InterContinental Hotels Group (IHG) is one of the largest and best-known hotel chains in the world with over 4,500 franchised, managed or owned hotels in nearly 100 countries. Total gross revenue from hotels in IHG's portfolio amounts to US$20bn.

IHG's internal audit team has 28 internal auditors globally: 11 in the UK; 12 in the US; 3 in Singapore; and 2 in China. The group's global head of internal audit, Bruce Vincent, says that the function formerly operated regionally, so that internal auditors in the US, for example, would concentrate solely on providing assurance on the US-based operations. Since joining in December 2008, Vincent has globalised the audit teams, so that finance audits, IT audits, and so on are conducted across the group as a whole.

"It made sense to centralise our efforts. It results in a better use of resources, a more consistent audit approach, and less duplication of work. It also provides more visibility of information – not just for audit, but also for management and other assurance providers," says Vincent.

IHG uses an integrated assurance model and risk-based internal audit approach that Vincent says helps internal audit define its coverage. "Following an integrated approach gives us a better idea of how other assurance providers understand risk, control it, and deliver assurance, so that we do not have to spend time reviewing the same risk areas and duplicate work," says Vincent.

"By understanding and assessing the effectiveness of the activities of other assurance providers, such as IT, legal, and risk management, against identified risks, we can work out whether we need to review some of these areas more deeply, or if we can prioritise our resources for reviews elsewhere," he adds

While the annual audit plan is prepared and approved by the audit committee between August and December, the function continuously reassesses this plan through a process known as "dynamic risk assessment". This process includes reassessment of both risk and organisational assurance information and allows internal audit to adapt to emerging risks and efficiently deploy resources.

"The dynamic risk assessment model allows us adjust the annual audit plan to take account of emerging risks and to reassess and

“We simply need flexibility built into our audit plan: we have already made dramatic changes to it within just the first quarter of the year” – Bruce Vincent, IHG

reprioritise assurance activities as required. We have a quarterly refresh to make sure that we are actually auditing the areas we need to, and whether there are areas where we should pull back from, or if we can rely on the assurance provided by other assurance providers within the business,” says Vincent.

“We simply need this flexibility built into our audit plan: we have already made dramatic changes to it within just the first quarter of the year and have switched our focus with regards to areas for review,” he adds.

At IHG, risk is assessed initially at a global organisational level and then cascaded into smaller component risks. This ensures that all identified risks can be clearly linked with significant organisational risks. “As a result,” says Vincent, “the scope and coverage of internal audit is broader than in some other organisations.”

“For example, reputational risk is a key boardroom risk at IHG and affects all areas of the group’s business, so it is an issue that takes up a lot of our time. We break this risk down into ‘auditable’ chunks: for example, we look at operational areas that can affect the brand – poor service, poor customer complaint handling, ineffective booking and billing systems, and so on, and then we work out the areas to review and how to approach it, how to resource it, and when to start.”

Vincent adds: “As part of a risk-based approach, internal audit has to focus on providing assurance over the areas of the business that management thinks are critical. Examining the complexity of the risk and the level of assurance needed defines the scope of our work.”

Auditing projects

All organisations undergo change and it is the responsibility of internal audit to challenge management to ensure that risks to change projects have been clearly identified, as well as provide assurance that these risks are being controlled.

Some projects fail to deliver their benefits, exceed costs, and over-run. Heads of internal audit discuss the role that their teams can play in providing assurance and advice

Mark Ripley, head of internal audit, Department for Work and Pensions (DWP)

The Department of Work and Pensions (DWP) is currently carrying out the biggest shake-up to pension and benefits provision since the welfare system was introduced. The department has 13 major projects currently in progress, including the development of "Universal Credit", a new single means-tested benefit.

Mark Ripley is the DWP's head of internal audit. He has a total staff of around 140, with 10 auditors dedicated to monitoring project risk – an area of assurance that accounts for around 20% of the team's annual programme.

Ripley says that his internal audit team is involved in every stage of a project's life-cycle – from the initial policy development; the development of the business case; the set up of the change structure and how the change is going to be managed; the project design, build, test and implementation (increasingly through "Agile" development – a flexible project management approach that enables organisations to review the project in stages as it proceeds); through to actual live running.

Ripley says that he has a number of questions that he asks before internal audit embarks on providing project assurance. "Firstly, internal audit needs to understand

"We are aligned to the project and programme life-cycle. We have continual engagement and provide periodic reporting" – Mark Ripley, DWP

the project and its deliverables. We need to understand the scope and scale of the project, how it is going to be carried out, where the key risks are and how these will change during the project and programme's life-cycle."

"We are aligned to the project and programme life-cycle," says Ripley. "We have continual engagement and provide periodic reporting," he adds. The DWP has an integrated assurance framework in place that Ripley says helps to ensure that all assurance providers share the same view of risk, and align reporting to management. However, he adds that "assurance for assurance's sake" can cause problems, especially where assurance providers are not properly aligned, effort is duplicated and the 'burden of assurance' becomes a project risk. "There is a risk that there can be more commentators on the project than people actually involved in delivery, or this is how it can feel to those involved," he says.

The DWP internal audit function uses assurance mapping to determine which assurance provider is responsible for looking at a particular aspect of the project's risks and which of these risks are being monitored. Ripley says that this helps define internal audit's activity in these areas – where internal audit should be providing direct assurance, or leveraging the work of others. Internal audit then works out the scope of its work, and partners with others, in a mutually supportive manner, to drive share understanding and perspectives.

Practical advice on auditing projects

1 Make sure internal audit understands what the project is trying to do, and how it is going to be carried out.

2 Ensure that part of the internal audit team has experience on working on projects, and that the function has the skills/resources to carry out the work.

3 Check that there is a mechanism for the project to be self-assessed.

4 Consider using an integrated assurance framework: this will provide more visibility about how the project is being run, as well as better management information. It will also highlight any gaps in assurance.

5 Conduct periodic reviews throughout the project life-cycle to see that the project is on track.

The DWP has its own portfolio management office that oversees all projects carried out by the department. There are also key sources of assurance through the risk management, programme management and information security teams, with internal audit providing independent assurance. In addition, in 2011 the government set up the Major Projects Authority (MPA) to scrutinise all major central government projects. The MPA ensures that there is a more systematic approach by departments to managing their major projects, including assessing viability before a project is initiated and undergoing regular, planned scrutiny to keep it on track.

"The key for us is to determine how we can continually use the assurances available from these other providers so that we can get an overall and clear view of risks and controls, and how we can develop trust and understanding to allow others to place reliance on us" says Ripley

Auditing projects

Steve Humphries, chief internal auditor, SABMiller

With its UK headquarters in Woking, SABMiller is the biggest drinks company in the FTSE 100 Index and is the second largest brewer in the world with an annual turnover of US$28bn. It has a global internal audit team of 140 people – nearly double if the internal auditors working in the group's joint venture companies are included. The group has operations in over 70 countries, and has internal auditors based locally in most of them.

Steve Humphries, the group's chief internal auditor, says that internal audit needs to engage with senior stakeholders at an early stage to explain why it should have a role in change projects, as well as to develop a good working relationship. This engagement should start with the audit and executive committees to highlight the risks involved with change projects in general and where internal audit should play a role.

Once internal audit has their support, the function needs to engage with the project board/global steering committee and thereafter with individual project managers. Internal audit should then agree with management the approach it will take and the scope of its review and terms of reference, adds Humphries.

This scope will be driven by many factors, such as the maturity and remit of the project's management office, and whether assurance is being provided by anyone else, like a consulting firm. Therefore, an early task for internal audit is to build up a map of other assurance providers to ensure that all the gaps are plugged, that there is no duplication, and that assurance activities are delivered using a common "language".

Humphries says that it is essential that the Project Management Office (PMO) operates effectively. "Internal audit needs to ask how the project, through the PMO, is self-assessed – if there is no way for project management to be able to tell if the project is going off-track, it is already dead in the water," says Humphries.

He also believes that internal audit needs to make it clear that it wants to achieve the same outcome as the project managers – a successful delivery. "As a result, it is important for internal audit to provide project advice, rather than just assurance," he says.

The internal audit function conducts regular reviews of projects throughout their life-cycle and these can vary in scope and intensity as internal audit deems necessary, or if specifically asked by management. For example the team carries out "health checks"

"I don't think that any internal audit function can add value to a project if it has no experienced auditors with project management experience"
– Steve Humphries, SABMiller

to re-examine the projects' objectives and progress, and to see if they both are still aligned, and that management is in control of both.

"Health checks are a good way of finding out whether all the stakeholders in the project still share the same view of the project's objectives and its risks. The process can involve interviewing all the senior stakeholders, project and business managers to find out how they think the project is being conducted and controlled, and whether they think the original benefits are still achievable given its scope," says Humphries.

Humphries says that internal auditors need to have prior experience of working on projects to be able to perform their role effectively. He also says that internal auditors should always be aware of the key issues that usually contribute to project failure, and the controls that should be put in place to mitigate them as a result.

Useful professional guidance

There are several professional guides available to help internal auditors in their approaches to auditing projects. The Global Technology Audit Guide, *Auditing IT projects,* is available at (**http://bit.ly/JtkNqX2009**), while *An introduction to auditing projects* can be found at (**http://bit.ly/KaWw5x**). Further guidance on internal audit's involvement in organisational change can be found at **http://bit.ly/u4hKva**.

Visit **www.iia.org.uk** for more information, including the "Knowledge Centre", which contains a wide range of resources on risk management and internal auditing.

"The function needs to demonstrate a strong background in project management – without that knowledge or experience then you are not in a position to add value, challenge project management, or suggest appropriate controls. This comes from experience of reviewing other projects, and by obtaining professional project management certification," says Humphries.

"I don't think that any internal audit function can add value to a project if it has no experienced auditors with project management experience. In fact, interventions by inexperienced auditors can be extremely dangerous and can result in false assurance," he adds.

Auditing projects

Clive Walker, director of internal audit, Transport for London (TfL)

Created in 2000, Transport for London (TfL) is the functional body of the Greater London Authority responsible for the capital's transport strategy. It oversees the London Underground, bus services, elements of surface rail and street maintenance for major routes. It has an internal audit department of 42 staff led by the director of internal audit, Clive Walker. There are nine internal auditors dedicated to auditing contracts and projects, which is led by TfL's senior audit manager (commercial) Roy Millard.

TfL's internal audit function has continuously played a role in providing assurance on all types of projects, but the relationship of this assurance to that provided by other assurance providers has been better defined since the organisation established an integrated assurance framework in 2011.

Walker says that the framework has increased visibility about the extent and type of assurance that functions such as health and safety, risk management, and the Programme Management Office are providing. It has also ensured that assurance providers share the same view of risk, and has helped to highlight gaps where there is little or no risk coverage.

"Adopting an integrated assurance framework provides the board and senior management with a better view of what is going on, and how risks are regarded, identified and managed throughout the organisation," says Walker. "It also provides internal audit with more information about the extent of coverage that other assurance providers are carrying out, and defines the scope and extent we provide assurance on projects. It has also led to less perception of duplication in review work," he adds.

Walker says that TfL is working on hundreds of projects at any one time, which vary substantially in cost, scope and timescale. "Internal audit is just one of the functions that provides assurance on how these projects are managed, and the level of our involvement depends on the extent of the assurance that other providers are giving," he says.

Internal audit's work in project management at TfL has typically been focused on two areas: taking a sample of projects and carrying out thematic reviews on particular aspects of project management, such as risk management, or engaging in audits of specific projects.

"Internal audit has an important role in ensuring that projects succeed and deliver the intended benefits on time, to specification, and to budget" – Clive Walker, TfL

Millard says that the first step is to find out how many projects there are and what they hope to achieve. "We consider reviews of projects based on their size, value and potential cost exposure to the organisation, as well as what their life-cycles are, and at which stages of the project we should get involved and can add value," he says.

"We also consider risk metrics: is the project critical to the business, or is it being done differently? Are there reputational and political risks? Is there a critical health and safety element? Will the project involve multiple stakeholders? Is the project already in trouble, and can it be turned around? As we follow a risk-based approach, we need to determine what impact specific risks will have to the project's delivery, and how critical they will be to the business," he adds.

Walker says that internal audit maintains a generic view of the project lifecycle to ensure that there is an independent and consistent view taken, irrespective of the various project and programme management methodologies in use throughout TfL. Internal audit then forms a risk-based approach by providing an overview of the generic activities expected for each audit area at each stage of the project lifecycle.

Walker says his audit function uses a scoring mechanism that provides an assessment of how critical these projects are and what internal audit needs to do on them. He then prioritises internal audit's resources to ensure an appropriate level of assurance.

"Internal audit has an important role in ensuring that projects succeed and deliver the intended benefits on time, to specification, and to budget," says Walker. "An integrated framework helps make the process easier as it shows more clearly where there are gaps in assurance, and who should be responsible for providing it. This increased visibility in management information should result in better programme delivery," he adds.

The relationship with the audit committee

Internal audit needs to work effectively with the audit committee to make sure that major risks are properly identified for review and that management is held to account.

The audit committee relies on internal audit to supply it with independent information on risk, control and governance. Heads of internal audit discuss how the two work together

Jonathan Stanley, head of internal audit, Enstar Group

Jonathan Stanley joined Enstar Group in 2007 as head of internal audit. The group acquires and manages insurance and reinsurance companies in "run-off", which means that while the insurer no longer writes insurance, it still has liabilities under existing policies.

The group has a team of four internal auditors: two are based in the UK office with him, while the other two are based in the US. Internal audit reports to around 40-50 stakeholders made up of chief executives, chief operating officers, chief financial officers, audit committees and other senior management. He reports directly to three audit committees: the group audit chair based in Hamilton, Bermuda; an audit committee in Australia for the group's Australian regulated entities; an audit committee for the group's Lloyds operations and subsidiary boards across the group.

Stanley attends every audit committee meeting, as well as every board meeting across the group where there is not an audit committee – either in person, or via phone or video-conference.

Audit committee and board meetings are quarterly, and there are around 32 meetings a year that Stanley has to submit reports for. "I go to Bermuda twice a year and I go to the European audit committee meetings, but I attend the Australian and US meetings either by phone or video-link," says Stanley. "I meet

> "It is important to have an open doorway to the audit committee so that any issues can be raised" – Jonathan Stanley, Enstar Group

the chair of the Australian audit committee once a year if necessary. Otherwise, we correspond via email or phone," he adds.

About a quarter of Stanley's time is spent on preparing reports for the group's various audit committees and boards. "At the end of the day, audit committee reports are the product we work on and they are a major part of what we do and the audit committee needs to have clear reporting and information," he says.

Each audit committee prioritises certain risks in different ways. For example, says Stanley, the Australian audit committee is very focused on regulatory compliance, while the UK audit committee categorises legal risk as a key area for assurance. On the other hand, the US audit committee is more concerned with strategic issues.

"It is important to understand the different needs of each audit committee, and to make sure that internal audit reviews the risk areas that each committee identifies as being key to their areas. The only way to do this is to keep in regular contact with the chairs of each committee to find out what they need from internal audit, and to let them know what internal audit can do for them," says Stanley.

"It is important to have an open doorway to the audit committee so that any issues can be raised. The relationship I have is formal, but friendly: I can approach the audit chairs whenever I need to and get their advice on what issues I should factor into the audit plan that I haven't already put to them," he says.

Stanley says that the group audit chair will usually ask internal audit for progress reports to make sure that management is putting recommendations in place, and that risks are being properly controlled. He will also check whether internal audit is resourced enough to carry out the work effectively on the audit plan, and whether the function is getting enough support from management.

Practical advice in fostering a good working relationship with the audit committee chair

1 Ensure you have access when necessary: make it clear that there will be times when you will need to speak to the audit committee chair prior to or after meetings. Similarly, make sure you are available if the audit committee has queries.

2 Know your audience: deliver the information that has been requested, in the way that the audit committee wants it – do members want summaries, full reports, or presentations?

3 Constantly demonstrate the value of internal audit: let the audit committee know what skills and experience the internal audit function has, and suggest other ways that it could add value or provide assurance.

"I see the chair of the group audit committee at least twice a year but it can be up to four times a year if either he or I request it. We also speak over the phone usually once a month and send emails to each other," he adds.

Management has put in place an induction process for new audit committee members. "In the UK we do this as part of best practice for audit committee members, but in Australia we have widened it to include executive and non-executive directors. In addition to providing directors with background to the business, the induction gives them an idea of what internal audit does, and how we can help them," he says.

The relationship with the audit committee

Jonathan Kidd, head of internal audit, Met Office

Jonathan Kidd, head of internal audit at the Met Office, reports to a non-executive chair of the audit committee. "I have a good, open relationship with the audit committee chair. I have access to him at all times via email and the phone in the first instance but there is no problem arranging a face to face meeting if I need to," says Kidd.

He adds that there is a good "two-way" information flow between them. "Every month we have an activity report that goes to the executive directors, the executive heads and the audit committee members," says Kidd.

"We go through what we have completed, and what we are about to start, and explain whether we are behind schedule or if we need further resources. Keeping the audit committee informed about our progress is key to building trust and earning respect," he adds.

Kidd says that he provides the audit committee with a list of audits that have been done and a summary of the main findings. He also provides members with a list of recommendations and actions that have been completed, and is upfront about highlighting which recommendations have not been implemented by management.

"We are very public about saying which recommendations and actions are overdue and we chase this with the management teams that are responsible for them. We keep the audit committee in the loop. Every quarter I take a report to the audit committee that also provides an update of where we are and a performance overview. The audit committee wants to know that we are independent and that we can stand up to management and provide an independent challenge," says Kidd.

One of the key ways to engage with the audit committee chair is to make sure that the head of internal audit delivers the level of detail requested. "It is important that internal audit is aware of who its audience is, and what it wants," says Kidd.

"The audit committee wants information but not in a massive amount of detail, unless it requests otherwise. Members want summaries of all reports, but they also want to see the full reports of areas where significant issues have been found. There is no point in overloading the committee with information it does not need on risks that are not critical to the business and that have been controlled," he adds.

“The audit committee wants to know that we are independent and that we can stand up to management and provide an independent challenge” – Jonathan Kidd, Met Office

Kidd says that there is a continual process of education that goes on through his close working relationship with the audit committee. “There is a section in the audit committee report called ‘Team update’ where I provide details of new skills, qualifications, training, and experience that the internal audit function has developed. This then informs the audit committee of new areas where we might be able to get involved,” he says.

Useful professional guidance

The *International Standard for the Professional Practice of Internal Auditing 1111* requires the head of internal audit to interact with the audit committee, and there a number of Practice Advisories that explains how this might be done, including Practice Advisory 1111-1 (**http://bit.ly/L5IEXE**); Practice Advisory 2010-1 (**http://bit.ly/KwycMp**); and Practice Advisory 2060-1 (**http://bit.ly/IXF7KS**).

The IIA issued a Practice Guide in August 2011 called *Interaction with the board* (**http://bit.ly/JFXO92**), as well as an audit committee briefing called *Working with internal audit* (**http://bit.ly/JpQpeH**).

The professional examinations also include references to the head of internal audit’s relationship with the audit committee. These are: *P3 Learning Text – Topic 5 (stakeholders and client-auditor relationships), Topic 6 (strategic internal audit planning); and M3 Learning Text – Topic 3 (corporate governance and assurance provision).*

Visit **www.iia.org.uk** for more information, including the “Knowledge Centre”, which contains a wide range of resources on risk management and internal auditing.

Risk-based internal audit

A risk-based internal audit approach allows internal audit to concentrate on reviewing the major risks to the organisation.

Energy group EDF's UK internal audit function uses a risk-based approach to provide assurance to the board. UK audit director Alistair Smith discusses how the approach works in practice

Électricité de France (EDF) is Europe's largest electricity utility company, and is the second largest in the world. Headquartered in Paris and listed on France's CAC exchange, the group posted €65.3bn in revenues in 2011. It has two principal business arms in the UK – EDF Energy and EDF Trading – and operates a diverse portfolio of 120,000+ megawatts of generation capacity in Europe, Latin America, Asia, the Middle East and Africa.

EDF's UK audit director, Alistair Smith, has implemented a risk-based internal audit approach as he believes that this is the best way to add value and provide assurance to the two audit committees in the UK (one for each business), the corporate audit team based in Paris and the group board.

"Internal audit's role is to provide assurance that key risks to the organisation's objectives are being well controlled. As a result, it makes sense that our audit programme is prioritised based on risk," he says.

Prioritising risk

Both EDF Energy and EDF Trading have separate risk management functions that are responsible for establishing risk policy, for supporting line managers in the development of a risk register and for co-ordinating the reporting of risks to the executive. As part of its reviews, internal audit monitors the effectiveness of risk management arrangements.

"Internal audit's role is to provide assurance that key risks to the organisation's objectives are being well controlled. As a result, it makes sense that our audit programme is prioritised based on risk" – Alistair Smith, EDF

EDF Energy's corporate risk policy sets out a three-tier approach to how people assess and report risks. These are listed as "critical", "significant", or "registered". While critical risks are prioritised by the business, Smith and his team of 20 internal auditors review them to see if the business' assessment is consistent with its findings. The EDF Trading risk policy and classification is separate, but the same audit approach applies.

As part of the planning process, the internal audit team looks at the organisation's risk register to see if it is complete and that there are no major risks missing. The function also considers which of these risks would have the most serious impact if controls were ineffective.

"The business scores these risks on the basis of controls that are in place rather than on an inherent basis, which means that there is a danger that some may be understated. When developing our audit plan, we need to consider whether the controls in place are well-designed and are working," says Smith. "Equally, we can add value by pointing out where too much resource is being targeted at risk control."

For EDF Trading, this involves internal audit talking to its executive team to discuss their views on risk and to see if the risk register accurately reflects them. For the larger EDF Energy business it involves talking to the seven-strong executive and the wider senior leadership team – which is made up of around 60 business managers. If there is a misalignment, new risks are added to the risk register and internal audit considers whether these risks should be added to its review programme.

Practical advice in implementing a risk-based internal audit approach

1 Review whether senior management and the business share the same view of risk – highlight where differences occur to ensure that the right risks and controls are targeted in the audit plan.

2 Identify and prioritise risks to be reviewed in each business area and develop an "audit universe" to ensure that no key business activities are overlooked and account is taken of previous audit coverage.

3 Develop an audit programme that stretches the team and promotes a high degree of productivity and limited downtime. For example, an auditor can work simultaneously on the reporting phase of one audit and the planning phase of the next.

4 Establish a "warning" system to notify internal audit whether recommendations for further action are being implemented on time and correctly.

5 Ensure that internal audit follows up on reports to check that senior managers are implementing internal audit's recommendations properly.

6 Risk-based internal audit is not just for large internal audit departments – the smaller the internal audit team, the more important it is for it to follow a risk-based approach. A risk-based internal audit approach can ensure that resources are prioritised on reviewing the controls for the most significant risks to the organisation's objectives.

7 The success of a risk-based internal audit approach is dependent on identifying the correct risks to review from the start. Internal audit must do this to add value to management as well as providing assurance to the audit committee.

The internal audit function relies on its "audit universe" – which provides the function with an organisation-wide view of risk – to determine which business activities and related risks require a review in the coming year. EDF's UK audit team and "audit universe" is split into four practices that reflect the organisation's different business areas – nuclear activities and thermal generation; energy supply and renewables; optimisation and trading; and corporate and steering functions. If an internal audit practice requires additional skills or resource, it can look for expertise within the wider internal audit function, from another part of the business, or from its external co-source provider.

The head of each audit practice maintains their own "audit universe", submitting an audit plan to the UK audit director based on the risks identified within that area of the business. Smith then puts the four internal audit plans together with his senior team, and submits a plan for the UK operations to the audit committee for approval based on the risk assessment, historic audit coverage, executive priorities and the group audit plan.

EDF's UK internal audit team is made up of 50% professional internal auditors, and 50% of people who have been recruited from the business who will stay with the team for around 2-3 years. Smith believes that this approach has several benefits. "By bringing people into internal audit from the business to work with us for a couple of years, we create a fluid team that is constantly being refreshed and has a mix of up-to-date business experience and expertise in audit methodology," he says. "When people return to their business area or move to a new activity, they do so with a wider knowledge of the company and a strong grounding in risk control."

The audit plan is put to the group's corporate audit team in Paris, which reviews it, suggests changes, and recommends additional areas to review as part of the group-wide audit programme. Every subsidiary around the group has to send a list of "top risks" to the group risk team every six months so that it is kept informed of emerging issues. These are shared with group audit to enable it to suggest additional reviews.

"One of the key steps to success with a risk-based approach is for internal audit to talk to the board and senior management to ensure that their 'top-down' view of big risks aligns with what internal audit has found in 'bottom-up' risk registers and from its current reviews" – Alistair Smith, EDF

Once the audit plan is finalised, Smith informs the UK audit team of the programme that has been agreed and talks to the EDF Energy and EDF Trading executive teams about the audit plan for their part of the business. Both executive teams have the opportunity to make further suggestions at this stage. He then meets with the audit committee of each business – one of the four quarterly meetings he holds with each every year – to sign off the audit plans.

Audit scope

The next step is to agree the scope of each audit review – the audit objectives, how many people should be involved and how long it should take to complete so that the internal audit function can properly resource it. As part of this process, the internal audit teams draw up a list of risks and controls that they expect to find in the area to be audited so that they can compare them with what they actually find in place. The teams develop a list of interviewees and a test plan.

Following interviews with people in the business and control testing, the internal audit teams validate the findings from the fieldwork and draft a report. The managing directors of the business areas are shown the audit findings and recommendations, often as "PowerPoint" presentations and an executive summary. When finalised, the report will go to the audit committee and corporate audit in Paris.

Internal audit also reviews the progress that the organisation's business areas have made in response to audit actions in implementing effective procedures to control risk. Action progress is reviewed at least quarterly and, one year after an audit report has been issued, the internal audit function issues a formal audit closure report that has ratings based on a traffic light system – "green" signifying that its recommendations have been completed, and "red" saying that key control actions still need attention. Internal audit takes a summary to the audit committee to discuss the central findings.

In advocating a risk-based internal audit approach, Smith acknowledges that there are some potential downsides that need to be managed. For example, if the internal audit function identifies the wrong risks to review, then the assurance provided may be of limited value to the business and key controls could go unchecked. Furthermore, a risk-based approach can require more up-front planning work – and more resource – than the traditional audit by rotation. Another problem is that a purely risk-based internal audit approach could mean that some low-level risks may escape any kind of formal monitoring, especially if there is not a good dialogue with second line assurance functions.

"One of the key steps to success with a risk-based approach is for internal audit to talk to the board and senior management to ensure that their 'top-down' view of big risks aligns with what internal audit has found in 'bottom-up' risk registers and from its current reviews," says Smith. "Providing these views are aligned, a risk-based internal audit approach can add value at all levels of the organisation."

Smith also believes that a risk-based internal audit approach is not limited to large internal audit departments. He believes that any size internal audit function can adopt the approach.

"The smaller the internal audit team, the more important it is for you to follow a risk-based approach so that you can make sure that your resources are prioritised to the most significant risks to the organisation's objectives," says Smith.

"If you have a team that only carries out 10 reviews a year, then they should be looking at the ten areas of risk that are of most concern and that the controls in these areas are working effectively," he adds.

Useful professional guidance

The *International Standards for the Professional Practice of Internal Auditing* cover risk-based internal audit planning in the 2010 series and in more detail in the related Practice Advisories: *PA2010-1 Linking the Audit Plan to Risk and Exposures* (**http://bit.ly/JNbjl2**) and *PA2010-2 Using the Risk Management Process in Internal Audit Planning* (**http://bit.ly/IueSgZ**).

The Chartered Institute of Internal Auditors has produced a position statement on risk-based internal auditing (**http://bit.ly/JSmSeu**) that is now used globally (**http://bit.ly/IVwEd0**). It has also produced a guide called *An Approach to implementing risk-based internal auditing* (**http://bit.ly/ISNU0Y**).

Global IIA has also produced "practice guides" that may be useful: *Assessing the adequacy of risk management using ISO 31000* (**http://bit.ly/IGBYBO**) and *Co-ordinating Risk Management and Assurance* (**http://bit.ly/GZNoj7**).

Professional qualifications also highlight the benefits of following risk-based internal audit. Both *P3 Learning Text – Topic 1 (internal audit and the organisation) and Effective Delivery of Audit and Assurance Learning Text* include a section on variations of the risk-based internal audit model.

Visit **www.iia.org.uk** for more information, including the "Knowledge Centre", which contains a wide range of resources on risk management and internal auditing.

Evaluating internal audit

All departments are faced with measuring their own performance, and internal audit also has to demonstrate its effectiveness – though the business case does not need to be about numbers.

Internal audit teams can find it difficult to show the positive impact they make on the business. The following case studies show how heads of internal audit are tackling that issue

David Finch, director of group business risk and assurance, Travis Perkins

Each year Travis Perkins assesses the effectiveness of internal audit. This satisfies both the Chartered Institute of Internal Auditors' mandatory requirement (Attribute Standard 1311) to have ongoing performance monitoring of internal audit, as well as the UK's Corporate Governance Code recommendation to audit committees to review internal audit. This is a multi-faceted review, aimed at providing a rounded perspective over the function's approach, activities, and interaction with management. The audit committee chairman also surveys senior management, the committee members, and external audit to find out what they think about internal audit's work.

David Finch, director of group business risk and assurance at Travis Perkins, says that one of the key performance measures used by the audit committee is the extent to which audit recommendations are implemented, and the timing of resolving actions. "Our quarterly reporting on the number of recommendations and completed actions to the executive committee (the operational committee of the PLC board) helps to reinforce managements' commitment and ensures timely management of issues," he says.

Finch uses several other ways to show the value that internal audit adds to the organisation, and how well its recommendations and actions are received by people in the business. For example, the audit team issues "feedback requests" after each piece of audit activity is completed. The results are then "scored" and a trend identified for each auditor, with the feedback being built into their personal development plans and – if necessary – into additional formalised training and development.

During the year, the internal audit function conducts a benchmarking exercise with other business organisations to determine ways in which the team can improve its effectiveness. Finch says that he is currently carrying out this initiative with another company in the same line of business that has multiple sites across the UK and Europe. "We are looking at how the

> "Ultimately, internal audit's value is determined by management's view of it and the relationship the function builds with management and the audit committee" – David Finch, Travis Perkins

audit teams in this organisation are structured compared to the size of the business. It is early days but it is a useful exercise," he says.

Furthermore, every September the internal audit function reviews its performance against the International Standards for Internal Auditing, and identifies ways in which performance can be improved further. "We measure ourselves against a 7-grade scale from 0 to 5 and 'not applicable'. Currently, we are non-compliant in just two areas, but we are working to change this," he says.

On a less frequent basis (typically every 3 to 5 years), Finch commissions an independent external evaluation to report on the function's effectiveness and highlight areas for possible improvement. He is currently considering the potential scope of an external quality assessment by the CIIA.

One of the problems that Finch – and other internal audit departments – has encountered is that management has not been aware of the benefits that the function brings to the business, or of the skills and expertise that internal auditors have and how they can be applied to the business. As a result, Finch feels that he needs to publicise internal audit's role and skillset more actively.

"In the past we have found that management doesn't always understand the role of internal audit and how its work is relevant to different parts of the business," says Finch. "As a result, on a quarterly basis we issue a newsletter called 'Managing Risk' that encompasses the various elements of business risk management. These are circulated out to the management teams, including the group finance director and the audit committee chairman," he says.

"Ultimately, internal audit's value is determined by management's view of it and the relationship the function builds with management and the audit committee," says Finch. "If internal audit is asked to carry out more reviews and to work in different areas, it is a good indicator that management holds stock in the team's abilities and opinions," he adds.

Finch says that it is also important to stress the cost-effectiveness of internal audit's activities. For example, the internal audit team assesses the financial impact of the review work that it carries out and flags up to management any cost savings achieved.

In 2011, for example, the internal audit team executed a series of reviews using Computer Assisted Audit Techniques to determine whether all VAT had been recovered, whether the correct rate of customs duties for imported goods had been applied, and if it had billed the correct amounts according to the commercial agreements in place with suppliers. By conducting these and similar reviews and collecting monies due, the internal audit function recovered funds in excess of its own annual budget. The work also led to further improvements in the control environment across central functions (such as finance, buying, property, and IT).

"The internal audit function essentially became a 'free of charge' service," says Finch. "If management wants to see the value we add in cash terms, we are able to provide the evidence," he adds.

Practical advice on evaluating the impact of internal audit

1 Issue feedback requests after every audit review, keep a "score" of comments from the business and act quickly and positively on the feedback.

2 Consider carrying out a benchmarking review with a similar sized organisation in the same industry sector to compare and contrast approaches to internal audit and resourcing.

3 Ask the CIIA to conduct an external review of the internal audit activity and approach.

4 Stress the importance of internal audit as an independent challenge to management, and that the function acts as a strategic partner to the business.

5 Keep management and the audit committee informed about the progress of internal audit work, and make them aware of other activities that the function might be able to provide expertise in.

6 Keep an up-to-date record of the number of recommendations that internal audit has made, and the number of actions that management has completed.

7 Review internal audit's performance annually against the professional Standards.

Evaluating internal audit

Arleen McGichen, head of internal audit, Ignis Asset Management

Ignis Asset Management is part of the Phoenix Group, which is the UK's largest specialist closed life and pension fund consolidator with over 6 million policyholders and £68.5bn of assets under management. Arleen McGichen, its head of internal audit, follows a framework to evaluate the effectiveness and impact of internal audit that was devised by Mike Dawson, senior audit manager at Phoenix Group. Her 6-strong team conducts an annual self-assessment, which comprises around 300 questions around internal audit positioning, resourcing, planning, methodology, reporting and quality.

The team also produces a questionnaire – incorporating input from the audit committee – which is sent out annually by the chief executive (to preserve independence) via the intranet to the senior management group. It has a simple 1-5 grading system ("strongly agree" to "strongly disagree") and the team gets a good response rate. Responses are not anonymised, so internal audit can follow up any comments with the individuals involved to improve the quality of its work.

In addition to the annual questionnaire, the function tries to get structured feedback from key auditees after every audit review on internal audit's performance during the planning, fieldwork and reporting phases. The feedback considers – among other issues – auditor competence, communication and commercialism.

Other methods involve using key performance indicators (KPIs) and timesheets. McGichen sets a list of KPIs with the audit committee that are contained in the audit charter. These include KPIs on planned delivery, the quality and value of the internal audit function – which checks whether it is focused on the key risk and assurance areas to the business – and how many of its recommended actions have been closed by management.

She uses timesheets to record audit activity and help with future audit planning. "Each member of the team is expected to spend about 80% of their time providing assurance, and the remaining 20% on training, personal development, administrative duties and holidays. By recording the amount of time it takes us to complete specific reviews, it shows the audit committee whether we are adequately resourced and if we are continuing to deliver value."

"It is much more difficult to put a metric against the value of the strategic advice that internal audit also provides" – Arleen McGichen, Ignis Asset Management

Furthermore, every year McGichen conducts an annual "gap analysis" against the International Standards for Internal Auditing to see that the team is following best practice. She also makes use of the CIIA's online member forums to ask for advice from other internal auditors about benchmarking the team's performance and demonstrating value.

"Internal audit has to be accountable and needs to demonstrate its own abilities and success. Showing where we add value and how we can deliver better and wider assurance builds trust with our stakeholders and improves our standing in the business," she says.

However, McGichen says that some aspects of internal audit do not lend themselves to being so easily measured. "It is perhaps easier to evaluate the process-driven side of internal audit's work, but it is much more difficult to put a metric against the value of the strategic advice that internal audit also provides," says McGichen.

"Internal audit helps support major change in the business, and provides assurance that these changes are managed in a controlled manner. The function also acts as an important independent challenge to management. Neither of these points should be underestimated, but it is hard to put a figure on them," she says.

Useful professional guidance

The *International Standards for the Professional Practice of Internal Auditing* and associated Practice Advisories cover the issue of validating internal audit quality in detail in the 1300 series.

Standard 1311 and the related Practice Advisory 1311-1 (**http://bit.ly/K7mkkh**) explain what internal assessment should look like. The Global Practice Guide, *Measuring internal audit effectiveness*, (**http://bit.ly/LxObwr**) will also prove useful. There is also a one-page balanced scorecard template that internal auditors can consider using (**http://bit.ly/JmzuL7**). The 1300 Standards series relate to quality assessment and improvement programmes. Standard 1312 requires an internal audit function to undertake an external quality assessment every five years at a minimum.

The Chartered Institute of Internal Auditors also has several reference and learning materials that may prove useful. For example, *P3 Learning Text – Topic 7 (planning for quality and continuous improvement)* features a section on performance measures, including the use of a balanced scorecard for internal audit. Added to that, there is a series of "PowerPoint" slides available on the CIIA's website on quality assessment and improvement programmes.

Visit **www.iia.org.uk** for more information, including the "Knowledge Centre", which contains a wide range of resources on risk management and internal auditing.

The series of case studies in this document have been produced by the Chartered Institute of Internal Auditors in collaboration with the National Audit Office, as part of a joint initiative to support the development of the internal audit profession in the public sector. With thanks to the contributors: British Telecom (BT), Department for Work and Pensions (DWP), EDF Energy, Enstar Group, Ignis Asset Management, InterContinental Hotels Group (IHG), The Met Office, Transport for London (TfL), Travis Perkins, SABMiller.

Useful links:

To access the case studies online

www.iia.org.uk/casestudies

To read the National Audit Office's review of Internal Audit in central Government

www.nao.org.uk/internal-audit-2012

About the Chartered Institute of Internal Auditors

- Established in 1948, we became the Chartered Institute of Internal Auditors in 2010.
- We are part of a global network of 170,000 members in 165 countries.
- All members across the globe work to the same International Standards and Code of Ethics.
- We have 8,000 members in all sectors in the UK and Ireland.
- Each year over 3,000 of our members take training with us or study for our qualifications.
- Over 2,000 members are Chartered Internal Auditors and use the designation CMIIA.
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