Internal Audit: Making Sure Your Own Defenses Are Not Your Weakest

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New Deloitte analysis of noncompliance

• Our analysis found that self-reported full compliance with the standards was remarkably similar for all types of entities.

• This suggests that the additional corporate governance and oversight that is required by an entity being a public company has little or no observable impact on the internal audit function’s compliance with professional standards.

• This could imply that those charged with governance either are not aware of the issue of noncompliance or do not consider compliance important.

<table>
<thead>
<tr>
<th>Claimed full compliance with IIA Standards by entity type</th>
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</thead>
<tbody>
<tr>
<td>Public sector/government</td>
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<tr>
<td>Not-for-profit/nongovernmental</td>
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<tr>
<td>Publicly traded company</td>
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<tr>
<td>Privately held company</td>
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Source: Deloitte analysis of IIA 2010 Global Internal Audit Survey data
New Deloitte analysis of noncompliance (continued)

Public company CAE-reported compliance with IIA Standard AS 1300, Quality Assurance and Improvement Program, by revenue/budget (USD)

Source: Deloitte analysis of IIA 2010 Global Internal Audit Survey data
New Deloitte analysis of noncompliance (continued)

• Compliance with AS 1300 is reportedly only 26 percent for public companies with revenues of $0.5 billion or less, therefore compliance with IIA Standards at those public companies may be as low as 26 percent.

• The major reasons given by CAEs for noncompliance are assertions that:
  - The standards are not appropriate for small entities
  - The standards require greater IA resources than are available
  - Compliance is not supported by management or the board

• The rate of compliance for entities with revenue or budgets over US$26 billion, where the first two reasons should not apply, is still only 60 percent.

• The core issue appears to be insufficient management and board support for their IA function to comply with the self-described “essential,” “mandatory,” and “basic requirements” set out in the IIA’s Standards.
Recommendations

Ask the head of internal audit:

• Has IA had an external quality assurance and risk-based assessment in the past five years? What were the results?

• Is the IA function in full compliance with all IIA Standards?

• If applicable, what are the reasons for noncompliance, when was the board informed of the noncompliance, and is there a formal plan to become compliant?

• If there is noncompliance, consult your entity’s legal adviser to understand potential legal and regulatory exposures that may arise. Identify potential reputational and other business risks, too.

• If there is noncompliance with IIA Standards, and hence also noncompliance with the IIA’s Code of Ethics by the chief audit executive, discuss the potential risks and the impact on the “tone from the top” that such noncompliance may create.
Recommendations (continued)

• Commission an independent strategic assessment of the IA function to identify other actions to help align it with your entity’s risks and obtain value from it.

• Work with your head of internal audit, CEO, and those charged with governance to consider any appropriate changes to bring your entity’s IA function promptly into full compliance with all IIA Standards and to align its activities strategically.
## Internal audit maturity and value continuum

<table>
<thead>
<tr>
<th>Attribute</th>
<th>Basic</th>
<th>High-Value</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Organization/People</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Competency</td>
<td>Financial</td>
<td>Financial and Operational</td>
</tr>
<tr>
<td>Governance</td>
<td>No Involvement</td>
<td>Limited Involvement</td>
</tr>
<tr>
<td>Charter/Role</td>
<td>Financial Controls and Compliance with Policy/Procedures</td>
<td>Financial Controls and Operational Effectiveness</td>
</tr>
<tr>
<td><strong>Processes/Methodologies</strong></td>
<td></td>
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<tr>
<td>Risk Focus</td>
<td>Financial and Compliance</td>
<td>Financial, Compliance, and Operational</td>
</tr>
<tr>
<td>Methods</td>
<td>Sarbanes-Oxley Controls and Compliance Checklists</td>
<td>Process and Controls Internal Audit Programs</td>
</tr>
<tr>
<td>Reports</td>
<td>Financial and Compliance Issues</td>
<td>Process and Operational Improvements</td>
</tr>
<tr>
<td><strong>Style</strong></td>
<td>Corporate Police/Reporter</td>
<td>Consultative</td>
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<tr>
<td><strong>Perspective</strong></td>
<td>Historical/Reactive</td>
<td>Current</td>
</tr>
<tr>
<td><strong>Technology</strong></td>
<td>Basic</td>
<td>Project Management and Administrative Systems</td>
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The value of internal audit

*Modern internal audit functions play a vital role in creating and preserving value to meet the changing needs of the organization*

**Not just compliance**
Provide greater scrutiny of emerging risk areas, adding value to the business and insight to management.

**Adds value up front**
Increased involvement in strategic projects, advising on risk management up front.

**Greater focus on untraditional risk areas**
Incorporates untraditional risk areas in operations, finance, security, privacy, and technology risk management.

**Infuses data analytics and technology**
Seamless use of data analytics, visualization, and other leading practices in security and technology.

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**Market Requirements**

- The NYSE requires listed companies to have an internal audit function.
- NASDAQ proposed a new rule to the SEC requiring that all listed companies have internal audit departments.
Value proposition of internal auditing for key stakeholders

What should you expect from your internal audit department?

Governing bodies and senior management rely on internal auditing for objective assurance and insight on the effectiveness and efficiency of governance, risk management, and internal control processes.

Internal auditing provides assurance on the organization’s governance, risk management, and control processes to help the organization achieve its strategic, operational, financial, and compliance objectives.

Internal auditing is a catalyst for improving an organization’s effectiveness and efficiency by providing insight and recommendations based on analyses and assessments of data and business processes.

With commitment to integrity and accountability, internal auditing provides value to governing bodies and senior management as an objective source of independent advice and counsel.
The evolution of internal audit – strategist and adviser/facilitator

The IA function is moving to higher maturity levels.
Questions for the CFO to consider

• Is the internal audit department properly funded and as cost-effective as possible? Does it have the resources it needs to meet expectations?
• Is internal audit responsive to the needs of today’s environment?
• Is internal audit cognizant of new laws, regulations, and best practices?
• Are internal audit personnel experts in their field and can they proactively consult on internal controls and risk management?
• Is the internal audit process designed to identify whether the organization is controlling those areas that are important to control and not just what is easy to control?
• Have the audit committee, senior management, and the CAE reconciled their expectations for internal audit?
Questions for the CFO to consider (continued)

• Is internal audit focused on the right risks areas?
• How does internal audit relate to, and interact with, other risk management-related functions, such as legal, security, environmental health and safety, loss prevention, quality and risk management, compliance, and credit risk? Are there duplications of effort or gaps between internal audit and these groups?
• Has management reached a supportable conclusion as to whether internal audit complies with IIA Standards?
• Is the internal audit department viewed as objective and competent by management and the independent auditors?
• Is internal audit properly positioned in the company and have the full support of management?