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The following section provides additional detailed steps to examine when evaluating an internal audit function. This appendix includes the evaluation procedures for selected sections of the Standards for the Professional Practice of Internal Auditing. Included also is methodology for the review of internal audit special projects. All of the Standards are not addressed in this appendix. The sections selected are those commonly cited as areas of concern.

In addition to compliance with the Standards, there are other methods of determining effectiveness for the internal audit function. These include surveying the key staff and external auditor about the services the internal audit department provides. A basic outline is included for this type of evaluation. The areas addressed are professionalism, meaningful audit findings and recommendations, and opinions from management and the board. This evaluation method is described in detail in the book *Evaluating the Effectiveness of Internal Audit Departments*. (Albrecht, W. Steve, Keith R. Howe, Dennis R. Schueler, and Kevin D. Stocks. *Evaluating the Effectiveness of Internal Audit Departments*. The Institute of Internal Auditors Research Foundation, 1988.)

STANDARDS FOR THE PROFESSIONAL PRACTICE OF INTERNAL AUDITING OF THE INSTITUTE OF INTERNAL AUDITORS

Standards for the Professional Practice of Internal Auditing differentiate among the varied responsibilities of the entity, the internal audit department, the director of internal auditing, and internal auditors. The Standards encompass:

- The independence of the internal audit department from the activities audited and the objectivity of internal auditors
- The proficiency of internal auditing work
- The scope of internal auditing work
- The performance of internal auditing assignments
- The management of the internal audit department

STANDARD 100-INDEPENDENCE

Internal auditors should be independent of the activities they audit.

- Review the organizational chart and the internal auditing charter to ensure that the internal audit function can accomplish its audit responsibilities.
- Evaluate the internal auditing charter or a similar document as it relates to independence.
- Review minutes of the board of directors or audit committee meetings to assess its relationship with the internal audit department.
- Determine if meetings are held periodically with senior management or the board of directors. Determine how often meetings are held and who usually attends.
- Determine how often the internal audit department prepares status reports and who receives copies.
- Review several recent status reports to decide whether they are clear, concise, and contain the following elements:
 - A summary of audit reports issued
 - Responses from auditees
 - Status of audits in relation to the audit plan
 - Changes to audit time budgets
 - An assessment of how the internal audit department is meeting its goals and objectives

- Reports on special projects
- Review the department’s conflict of interest policy and procedures to learn if they are adequate to ensure objectivity.
- Review internal audit organizational charts, position descriptions, internal auditing policies and procedures manual, the statement of responsibilities, and similar documents for a description of the internal auditors’ reporting responsibilities.
- Review the budget approval process and assess its impact on independence.
- Review the internal audit department’s financial budgets for the past two years.
- Determine if the budget is sufficient to adequately pay the staff and to provide training.
- Review audit assignments for prior periods and verify that auditor rotation fosters independence.

**STANDARD 200 -
PROFESSIONAL
PROFICIENCY**

Internal audits should be performed with proficiency and due professional care.

- Determine if audit personnel are familiar with the *Code of Ethics* of the Institute of Internal Auditors.
- Review and evaluate the education and background of the auditing staff, continuing professional education, and the personnel performance evaluation process. See detailed review procedures below - Professional Proficiency - Standard 220.
- Evaluate supervision to learn if it is a continuing process. See detailed review procedures below - Supervision - Standard 230.
- Determine if the entity has adopted a policy to ensure that the internal audit director is notified promptly of existing or suspected fraudulent situations.
- Determine whether the internal auditors comply with their responsibilities as they relate to deterring, detecting, investigating, and reporting fraud. See detailed review procedures below - Due Professional Care - Standard 280.
- Evaluate technical references and library facilities.
- **Standard 210 - Staffing**
 - Review the educational and professional background of the internal audit staff members. Determine if the staff possesses the appropriate accounting, auditing, MIS skills, and related experience and education.
 - Review job descriptions for staff positions. Determine if:
 - ... Position descriptions exist for each level of audit staff.
 - ... Job descriptions provide suitable criteria for education and experience.
 - ... Each staff member meets the criteria of education and experience.

- ... Job descriptions for each level of audit staff are appropriate.
- **Standard 220 - Knowledge, Skills, and Disciplines**
 - Review information on specialized skills required by the auditing department. Determine if:
 - ... The director of internal auditing is a certified public accountant or a certified internal auditor.
 - ... Any specialized skills or expertises are required to meet the unique need of the entity effectively.
 - ... Specialized skills are needed. Does current staff possess these skills?
 - ... Any consultants were used during the review period. If so, were the qualifications of the consultants and the type of assistance provided appropriate?
 - Continuing Education
 - ... Review continuing education.
 - ... Determine if there is a written continuing education policy.
 - ... Determine if departmental policy requires a specific number hours per year of continuing professional education for each auditor and if it meet the requirements of government auditing standards.
 - ... Review the department's training records. Determine if they are sufficient, complete, and current.
 - ... Review the courses taken during the past two years. Determine if:
 - ▶ All auditors received training according to policy.
 - ▶ The training was appropriate.
 - ▶ Supervisors received training in personnel management skills.
 - Performance Evaluations
 - ... Review samples of performance evaluation forms.
 - ... Determine if all personnel receive at least annual performance appraisals and counseling.
 - ... Determine if a policy exists regarding the evaluations of internal auditors after each audit. If so:
 - ▶ Determine the minimum hours necessary that requires an evaluation, and determine if the minimum is reasonable.
 - ▶ Select a sample of audit projects from the departmental status reports and determine whether the evaluations were prepared according to departmental policy.

- **Standard 230 - Supervision**
 - Determine the working papers provided evidence of supervisory review. Describe the method used (dates and initials on individual working papers, memo describing the nature and extent of review, etc.).
 - Determine whether the director of internal auditing or another supervisor provided opportunities during the audit for staff members to discuss changes to the scope, objectives, or procedures.
 - If appropriate, determine whether the auditors could communicate differences of opinion beyond their immediate supervisors and whether the working papers show how they resolved the situation.
 - Determine whether the supervisory review appeared to have addressed:
 - ... Whether audit objectives were met.
 - ... Whether audit program steps were properly carried out.
 - ... Whether revisions to audit programs were proper and timely.
 - ... Whether working papers adequately supported the auditors' findings, conclusions, and recommendations.
 - ... Whether established audit policies and procedures were followed.
 - Determine if the review of working papers was timely.

- **Standard 280 - Due Professional Care**
 - Determine if internal auditors met their responsibility for assisting in the deterrence of fraud by evaluating and testing the adequacy and effectiveness of internal controls commensurate with the exposure and risk of the audited area. For example, did internal auditors determine if:
 - ... The entity environment fostered control consciousness.
 - ... Realistic entity goals and objectives were set.
 - ... Written policies (code of conduct) existed that described prohibited activities and the action required whenever violations were discovered.
 - ... Appropriate authorization policies for transactions were established and maintained.
 - ... Policies, practices, procedures, reports, and other mechanisms were developed to monitor activities and safeguard assets, particularly in high-risk areas.
 - ... Communication channels provided management with adequate and reliable information.
 - ... Recommendations were needed for the establishment or enhancement of cost-effective controls to help deter fraud.

- Determine if internal auditors were alert to opportunities that could allow fraud. If significant control weaknesses were detected, determine if internal auditors:
 - ... Conducted additional tests directed toward the identification of other indicators of fraud, such as unauthorized transactions, overrides of controls, unexplained pricing exceptions, or unusually large losses.
 - ... Evaluated the indicators that fraud might have been committed and decided whether any further action was necessary or whether an investigation should have been recommended.
 - ... Notified the appropriate authorities within the entity in instances when internal audit made a determination that there was sufficient indicators of the commission of fraud to recommend an investigation.

STANDARD 300 - SCOPE OF WORK

The scope of internal auditing should encompass the examination and evaluation of the adequacy and effectiveness of the organization’s system of internal control and the quality of performance in carrying out assigned responsibilities.

- Review and evaluate the internal audit department’s plans and confirm that the plans are defined, measurable, approved by management and the board, and related to specific operating plans and budgets.
- Assess progress toward achieving the audit plan.
- Determine if each of the five objectives included in the Standards were included as part of the audit work performed. Based on the objectives and the procedures performed, classify the scope of the audit:
 - Reliability and integrity of information (Standard 310)
 - Compliance with policies, plans, procedures, laws or regulations (Standard 320)
 - Safeguarding assets (Standard 330)
 - Economic and efficient use of resources (Standard 340)
 - Accomplishment of established goals and objectives for programs or operations (Standard 350)
- **Standard 310 - Reliability and Integrity of Information**
 - If the scope of the audit included a review of the reliability and integrity of information, determine if the audit program included appropriate procedures to detect that:
 - ... Records were adequate and current.
 - ... Transactions had been properly reviewed and approved.
 - ... Information systems produced data that were accurate, timely and relevant.
 - ... Adequate controls existed to detect or prevent errors and irregularities.

- Determine if the auditors tested the key controls identified or said why the controls were not tested.
- If the scope did not include “reliability and integrity of information” control objectives, determine if this omission was appropriate.
- **Standard 320 - Compliance with Policies, Procedures, Laws, and Regulations**
 - If the scope of the audit included a review of systems established to ensure compliance with policies, procedures, laws, regulations, and other items that could have a significant impact on operations, determine whether the auditors obtained sufficient background information and legal or other expert advice to identify and interpret these items.
 - Determine if the auditors tested key controls designed to ensure compliance or indicated why controls were not tested.
 - If the scope did not include “compliance” control objectives, determine if this omission was appropriate.
- **Standard 330 - Safeguard Assets**
 - If the scope of the audit included a review of the means to safeguard assets, determine the audit program contained adequate procedures to determine the:
 - ... Adequacy of the separation of duties.
 - ... Rotation of sensitive duties among employees.
 - ... Adequacy of reconciliation procedures.
 - ... Adequacy of management’s periodic surprise reviews.
 - ... Review and approval of transactions by authorized individuals.
 - ... Adequacy of the physical protection of assets and records.
 - Determine if the auditors tested key controls designed to ensure compliance with the safeguard of assets or stated why the controls were not tested.
 - If the scope did not include “safeguarding assets” control objectives, determine whether this omission was appropriate.
- **Standard 340 - Economy and Efficiency**
 - If the scope of the audit included an appraisal of the economy and efficiency with which resources were employed, determine if the auditors:
 - ... Identified operating standards.
 - ... Determined if auditees understood these standards.
 - ... Determined if the standards were appropriate in keeping with the entity’s goals and objectives.
 - ... Determined whether standards were met.

- ... Identified and analyzed deviations from the standards.
- ... Discussed deviations with proper individuals.
- ... Identified inefficient or non-economic uses of resources.
- ... Determine if the auditors tested key controls designed to ensure the appraisal of the economic controls were not tested.
- ... If the scope did not include “economy and efficiency” control objectives, determine if this omission was appropriate.

- **Standard 350 - Goals and Objectives**

- If the scope of the audit included a review to detect whether programs were meeting established objectives and goals, determine if the auditors:
 - ... Identified relevant objectives and goals and the systems for measuring how well these were met.
 - ... Established criteria for evaluating the program’s effectiveness.
 - ... Determined whether objectives and goals were met.
 - ... Assessed techniques and data that the auditee used to measure effectiveness and the action taken in response to these measurements.
 - ... Reviewed for evidence that the auditee was looking for cost-effective ways to accomplish objectives and goals.
 - ... Estimated the costs and benefits of not meeting goals.
- Determine if the auditors tested the key controls designed to ensure programs were meeting established objectives and goals.
- If the scope did not include “accomplishment of goals and objectives” controls objectives, determine if the omission was appropriate.

**STANDARD 400 -
PERFORMANCE OF
AUDIT WORK**

Audit work should include planning the audit, examining and evaluating information, communication results, and follow up.

- Select a representative sample of audits and perform a general review and specific tests of each (Standards 410, 420, and 430).
- Determine if the policy of follow up ensures responses to all recommendations and includes an evaluation of whether corrective actions are achieving the desired results (Standard 440).
- **Standard 410- Planning the Audit**
 - Determine if the scope and objectives of the audit were specified in writing as part of the audit planning.
 - Determine if the director of internal auditing or another supervisor prepared a planning memorandum for assigning staff to the audit. Determine if the staff assigned to the audit had the proper education and experience necessary for the work to be

- performed.
- Determine whether the auditors obtained background information about following items:
 - ... Duties and responsibilities of the auditee
 - ... Organizational charts
 - ... Financial Budgets
 - ... Relevant entity policies and procedures (particularly any recent changes)
 - ... Developments and practices in the industry
 - ... Relevant government regulations
 - ... Prior internal audit reports and working papers
 - ... External audit reports and working papers
 - ... Determine if the auditors documented the results of the review of background information
- Determine if the auditee was notified of the estimated start date and the duration of the audit, the personnel assigned to the audit, and the physical facilities required.
- Determine if an opening conference was held with the auditee's management that included the following:
 - ... A discussion of planned scope and objectives
 - ... The auditee's comments and suggestions about the audit
 - ... When and with whom findings would be discussed
 - ... Determine if the opening conference adequately documented
- Determine if a preliminary survey conducted to obtain information about the area to be audited.
 - ... Describe the techniques used to conduct the survey (interviewing personnel, on-site observation, reviewing manuals, system walk-through).
- Determine if the auditors consider the survey results in establishing their time budget. Determine if the budget appears reasonable, based on the planned scope and the procedures.
- Learn if the members of the audit team were notified of the audit scope and objectives, the planned assignments, and the time budget.
- Determine if planning was adequately documented.
- Determine the extent to which the audit was coordinated with the independent outside auditor. Review the nature of the coordination or comment as to the lack of it.
- Determine whether the auditors studied and evaluated the system of internal controls and evaluated the:
 - ... Responsibility for tasks and duties was appropriately assigned.
 - ... Written operating policies and procedures existed.
 - ... Supervisory review and approval were appropriate (management should not be able to override controls).

- ... Weaknesses in the system.
- ... Causes of and significance of weaknesses.
- ... Strengths in the system (key controls).
- ... The overall adequacy and effectiveness of the system of internal controls.
- Determine whether the documentation of the study and evaluation of internal controls:
 - ... Identified controls to be tested (this should be cross-referenced to audit program steps).
 - ... Explained “No” and “N/A” answers on internal control questionnaires.
 - ... Provided an adequate picture of the control system in place.
- If there was no study of internal controls, or if the evaluation was not documented, determine if the working papers explained why this was not done.
- Determine if the working papers contained a written audit program.
 - ... Determine if the program was:
 - ▶ Based on the review of internal controls.
 - ▶ Used to investigate problem areas found in the preliminary survey.
 - ▶ Approved by the audit director or another supervisor before the audit work began.
 - ▶ Used as a guide for procedures to be performed.
 - ▶ Signed off to show the completion of program steps or marked “N/A” with an explanation to why the steps were not performed.
 - ▶ Referenced to supporting working papers.
 - ... Review the audit program to detect the internal auditing director or another supervisor approved changes before being performed.
- **Standard 420 - Examining and Evaluating Information**
 - Determine if the nature and extent of the work the auditors performed were adequate to meet the stated scope and objectives of the audit.
 - Review the working papers to find if they supported the findings, conclusions, and recommendations contained in the audit report.
 - ... Evaluate whether the auditors obtained sufficient, relevant, and useful information to support their findings and conclusions.
 - ... If the information was unavailable to the auditors (missing documents) or the auditee did not provide

- necessary information, determine whether the auditors acted accordingly.
 - If findings from the working papers were not included in the report, evaluate the explanation of why these were excluded.
 - If the auditors' findings say that changes should have been made to the audit procedures, determine if they made them and if supervisory personnel approved the new procedures before they were performed.
 - Review working papers in the file and determine whether they were:
 - ... Cross-referenced to the audit program.
 - ... Labeled with a heading describing name and location of the auditee, the date or period of the audit, and the specific test that the working paper supports.
 - ... Initialed and dated by the preparer.
 - ... Indexed and numbered systematically and according to departmental policies.
 - ... Documented to show the source of the information examined.
 - ... Marked with footnotes that explain any symbols used.
 - ... Cross-referenced to related working papers (including those filed in a permanent file).
 - Determine if the working papers contain:
 - ... Adequate evidence of the objectives and work performed.
 - ... Adequate explanations of sample selection procedures.
 - ... Summaries describing test results, conclusions, and recommendations.
 - ... Adequate explanations of procedures that were not performed.
 - ... Evidence of discussions with the auditee about findings and recommendations.
 - Determine if the working papers were prepared using guidelines governing their form and content.
- **Standard 430 - Communicating Results**
 - If the audit findings or the time needed to complete the project made an interim report desirable, determine whether one was issued. Determine if it provided the auditee with relevant information during the audit and permitted timely corrective action.
 - Determine if an exit conference was held with the auditee to discuss findings and recommendations before the final report was issued. Determine if the working papers adequately documented the discussion at the exit conference (attendees, items discussed,

- management’s comments, etc.).
- Determine if the director or audit manager reviewed the audit work before the report was released to management.
- Determine whether the audit report:
 - ... was signed by the internal auditing director or his designee
 - ... followed an appropriate format
 - ... presented findings and recommendations clearly, completely, factually, and objectively
 - ... focused on improvement rather than criticism
 - ... was retained in the working paper files
- The report:
 - ... identifies the location audited
 - ... states the purpose, scope, and objectives
 - ... adequately describes any scope limitations and how they affected the procedures used
 - ... presents findings logically with an emphasis on significant items
 - ▶ contain sufficient supporting information for the findings
 - ▶ state an overall opinion relating to the scope and objectives, including appropriate references to regulations, policies, etc.
 - ▶ identify weaknesses in the system of internal control and the causes of the weakness
 - ▶ include practical suggestions for correcting weaknesses that address the causes
 - ▶ acknowledge positive accomplishments and corrective actions
 - ▶ identify areas needing additional study
 - ▶ contain an executive summary
 - ▶ show cross-references to supporting working papers
 - ▶ contain only findings or comments that the working papers support
- Determine if the audit report was issued to auditees and management with sufficient authority to make recommended corrections and to the board.
- Determine if the audit report included management’s responses to the findings and recommendations.
- If the working papers contain any evidence of a conflict between management and the auditors over findings or recommendations, indicate how the auditors handled this. Determine if they:
 - ... discussed the problems with the auditees
 - ... attempted to obtain a satisfactory response
 - ... reported the conflict to someone who could resolve the

issue
 . . . requested a resolution of the problem

- **Standard 440 - Follow Up**
 - Determine if the auditors received management’s response to the audit report. If not, determine if the working papers contain evidence that the auditors followed up to obtain the response.
 - Determine if the working papers contained evidence that the auditors reviewed the response for adequacy and propriety.
 - . . . Do the responses:
 - ▶ address the findings and the recommendations in the report
 - ▶ promise action that will achieve the desired results
 - ▶ commit to a timely course of action
 - . . . If management has determined not to take corrective action, determine the working papers contain evidence that management or the board of directors has consciously assumed the risk of the decision.
 - Determine if the auditors have scheduled or conducted a follow-up review to ensure that the corrective action promised was eventually taken.

**STANDARD 500 -
 MANAGEMENT OF THE
 INTERNAL AUDIT
 DEPARTMENT**

The Director of Internal Auditing Should Properly Manage the Internal Audit Department.

- Determine if written policies exist for the internal audit department.
- Review and evaluate the department’s quality assurance policy for internal and external reviews.
- Determine the extent of coordination with external auditors to avoid duplication of audit effort. Usually, audit plans should be shared, working papers reviewed by both parties, and periodic meetings held.
- Determine whether annual goals, objectives, and performance measures are developed with the concurrence of the responsible entity officials and the board.
 - The goals can be accomplished within specified operating plans and budgets.
 - The goals should be measurable.
 - Assess techniques and data used to measure effectiveness and the action taken in response to these measurements.
- If a timekeeping system exists, determine if it is manual or automated and whether it is effective, efficient, and appropriate based on the size of the audit staff.
- Review to find out the working papers contain a time budget analysis for the project that identifies:

- Hours budgeted by audit segment.
- Actual hours by audit segment.
- Variances between budget and actual hours with explanations of material variances.
- Analyze time summaries to decide whether the total hours are reasonable for the number of staff auditors (standard hours are 2,080 per year). Based on this analysis, determine if total hours seem accurate and complete.
- Determine if procedures were in place to ensure that the director (or another supervisor) was kept abreast of the status of the audit.
- **Standard 520 - Staffing Analysis - Planning**
 - Obtain and review the current organizational chart of the internal audit department.
 - ... Determine the number and levels of the staff (both approved and filled).
 - ... Determine whether the internal audit department prepared a staffing analysis as a part of the planning process.
 - ... Review and evaluate the staffing analysis for completeness, accuracy, and appropriateness.
 - ... Determine whether the number and levels of existing staff are in accordance with the staffing analysis prepared by the internal audit department.
 - If the size of the audit staff does not permit complete coverage of the audit cycle based on the risk assessment, determine if the process used to defer or reschedule audits was reasonable. Also determine if the board of directors or senior management was made aware of the effects of the reduced audit coverage.

SPECIAL PROJECTS

- Review the list of special projects provided by the internal audit department. On a test basis:
 - Determine if special projects were approved and reported to the board of directors or responsible management officials.
 - Determine if the special projects were of a type that could impair independence. If so, determine what steps were taken to mitigate this impairment.
 - Determine if normal department standards for conducting audits were followed in performing special projects (working paper standards, planning procedures, etc.).

EFFECTIVENESS OF THE INTERNAL AUDIT FUNCTION

Determine if the internal audit function is meeting the needs of the entity it serves.

- Survey key members of the entity’s board and staff. These should

- include:
 - the chief administrator
 - chief financial officer
 - the audit committee chair or a board member
 - at least two operating managers who have recently been audited
 - the partner or audit manager in charge of the external audit
 - the internal audit director
 - at least two internal audit staff members
- Evaluate both the quantitative and qualitative criteria when reviewing the performance of the internal audit function.
 - Quantitative criteria are those measures of effectiveness that are measurable and documentable. They include criteria such as:
 - ... dollars saved versus cost of operating the internal audit function
 - ... number of reports and findings
 - ... percent of time spent auditing
 - ... number of auditors per dollar of assets or revenues
 - ... actual costs versus budgeted costs
 - ... completion of the audit plan
 - Qualitative criteria of effectiveness are not strictly measurable and may not be documentable with hard evidence of fact. These include:
 - ... feedback from auditees
 - ... meaningful findings and recommendations
 - ... professionalism
 - Factors which may be used as criteria for evaluating effectiveness:
 - ... Meaningful audit findings and recommendations
 - ... Auditee's response and feedback
 - ... The professionalism of the internal audit department
 - ... Adherence to the audit plan
 - ... The absence of surprises for management and the board
 - ... Cost effectiveness of the Internal Audit Department
 - ... Personnel development
 - ... The external auditor's evaluation of the Internal Audit Department
 - ... Feedback from operating management
 - ... The number of requests for audit work
 - ... The director's annual report
 - ... The audit committee's evaluation of the Internal Audit Department
 - ... The quality of working papers
 - ... Results of internal reviews
 - ... Feedback from peers