

Audit Committee Institute Evaluation of internal auditors

KPMG's AUDIT COMMITTEE INSTITUTE

The current spate of restated financial statements, missed earnings projections, and high profile corporate failures has sent a brisk current of change sweeping through boardrooms aimed at strengthening the independence and effectiveness of audit committees.

In response, audit committee members have been more focused than ever on enhancing both the effectiveness and efficiency of their audit committees, including improving the interaction of the audit committee with management, internal audit, and the external auditors. Indeed, the importance of the relationship between audit committees and internal auditors is being increasingly recognised.

While the statutory auditor is responsible for auditing the company's financial statements and forming an opinion as to their truth and fairness; the internal auditor is responsible for providing objective assurance as to the adequacy and effectiveness of a company's risk management and control framework. Each has its own unique responsibilities, but the audit committee should determine that they complement each other, that their audit effort is coordinated, and that they communicate effectively.

The audit committee should evaluate internal audit based on its own experiences and ask management and external audit to provide their own assessments. Where the organisation has subsidiaries or distinct business units, it may be appropriate to request their management to complete a questionnaire. In addition to these assessments, the head of internal audit should be requested to self-assess the department's performance. This process may identify other issues, including matters relating to the audit committee's own performance, the performance of management or the performance of external audit.

This paper provides a four-part checklist of questions to consider as part of an integrated framework for the assessment of the internal audit function that should be completed by the following:

- Audit committee (initial assessment)
- Management
- External auditor
- Head of internal audit

The audit committee should aim to ensure they have appropriately qualified resource to provide answers to these questions and to consider the implications of the findings.

A number of advisory firms, including KPMG who sponsor the Audit Committee Institute (ACI), have established methodologies that offer a means to assess the effectiveness of the internal audit function. These assess internal audit against best practice principles and provide recommendations to strategically reposition internal audit.

Evaluation of internal auditors - Audit committee

This checklist should be completed by the audit committee prior to feedback from other areas of the organisation

Understanding

How well does internal audit demonstrate that it:

	Strong	Adequate	Needs improvement
▪ Recognises its accountability to the audit committee;	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
▪ Has a strong understanding of the responsibilities and operation of the audit committee;	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
▪ Understands the expectations of the audit committee and the chairman;	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
▪ Understand the organisation's business and risk environment?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Does internal audit consistently demonstrate a realistic and commercial view of the business?

Yes	No
<input type="checkbox"/>	<input type="checkbox"/>

Comments

Charter and structure

Do the terms of reference for internal audit define:

	Yes	No
▪ Roles and responsibilities, including those in relation to other internal functions;	<input type="checkbox"/>	<input type="checkbox"/>
▪ Expectations of management;	<input type="checkbox"/>	<input type="checkbox"/>
▪ Scope of internal audit work;	<input type="checkbox"/>	<input type="checkbox"/>
▪ Minimum resources;	<input type="checkbox"/>	<input type="checkbox"/>
▪ Access to information?	<input type="checkbox"/>	<input type="checkbox"/>
Has internal audit's terms of reference been reviewed within the last two years?	<input type="checkbox"/>	<input type="checkbox"/>

	Strong	Adequate	Needs improvement
Evaluate internal audit's terms of reference in light of the organisation's current needs.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Evaluate internal audit's current terms of reference in light of the organisation's future needs.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

	Yes	No
Are internal audit's terms of reference visible to everyone in the organisation?	<input type="checkbox"/>	<input type="checkbox"/>
Does the structure of internal audit facilitate:		
▪ Consistency in the quality of service to the organisation;	<input type="checkbox"/>	<input type="checkbox"/>
▪ Understanding of the organisation's business issues;	<input type="checkbox"/>	<input type="checkbox"/>
▪ The delivering of value to the organisation?	<input type="checkbox"/>	<input type="checkbox"/>

Comments

Skills and experiences

	Strong	Adequate	Needs improvement
How well does internal audit's staffing reflect it roles and responsibilities?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
On the basis of the work performed by internal audit over the past 12 months, does internal audit appear to have the right staff mix and competencies in specialist areas such as IT and Treasury and the necessary geographical coverage?		Yes <input type="checkbox"/>	No <input type="checkbox"/>
Does the internal audit team have an appropriate program of continuing education?		<input type="checkbox"/>	<input type="checkbox"/>

	Strong	Adequate	Needs improvement
Evaluate internal audit's independence from the activities it audits.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
How would you assess the committee's confidence in internal audit?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Comments

Communication

	Yes	No
Has internal audit attended all the audit committee meetings it was scheduled to attend?	<input type="checkbox"/>	<input type="checkbox"/>
Has internal audit made itself available for consultation outside of audit committee meetings?	<input type="checkbox"/>	<input type="checkbox"/>

	Strong	Adequate	Needs improvement
Evaluate internal audit's responsiveness to requests from the audit committee, including requests for special investigations.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Evaluate internal audit's frankness and candour with the committee.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Evaluate internal audit's handling of difficult or contentious issues.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Does internal audit determine that the chairman of the audit committee is fully briefed on significant findings or developments prior to audit committee meetings? Yes
 No

Evaluate the usual level of preparation for audit committee meetings demonstrated by internal audit. Strong
 Adequate
 Needs improvement

Evaluate the quality of internal audit reports and papers tabled with the audit committee. Consider their relevant and clarity.

Have reports been received from internal audit on a sufficiently timely basis? Yes
 No

Does internal audit promptly advise the audit committee about significant issues and significant developments, including on special projects such as fraud investigations?

Does internal audit promptly advise the committee about significant changes to the internal audit plan?

Evaluate the strength of internal audit's process to monitor the status of open matters/recommendations. Strong
 Adequate
 Needs improvement

Does internal audit contribute to the committee's understanding of the overall assurance framework within the organisation and the role internal audit plays in this framework? Yes
 No

Does the internal audit function proactively share its knowledge widely with the business i.e. outside the strict reporting channels?

Comments

Performance

This section should include questions that focus on the Key Performance Indicators (KPIs) for the internal audit team

Assess the quality of the internal audit plan in terms of:

- Comprehensiveness, clarity and timeliness; Strong
 Adequate
 Needs improvement
- Coverage of priority and high risk areas;
- Focus on testing the control framework.

Did the original internal audit plan leave any significant issues of concern to the audit committee unaddressed? Yes
 No

What was your assessment of the scope of the internal audit as outlined in the plan? Strong
 Adequate
 Needs improvement

Was it clear from its reporting to the committee that internal audit:

- Delivered the services outlined in the plan;
- Were in accordance with the agreed timetable?

Yes No

Is there evidence of effective coordination of internal and external audit work?

Are success measures used for evaluating the performance of the internal audit function?

Does the internal audit function offer adequate career progression opportunities for its employees?

Are there sufficient performance based reward mechanisms to motivate internal audit employees?

Do you consider that internal audit has added value to the organisation?

In what way has internal audit added value to the organisation?

How would you assess internal audit's overall performance?

Strong Adequate Needs improvement

Overall comments

Name

Signed

Position

Date

(Audit Committee Chairman)

Evaluation of internal auditors - Management

This checklist should be completed by heads of major business units and the chief financial officer/finance director. Where significant subsidiaries or major business units are subject to internal audit, consider asking leaders of these businesses to complete the survey.

Planning

	Yes	No
Are internal audit's terms of reference sufficiently visible to everyone in your business?	<input type="checkbox"/>	<input type="checkbox"/>
Was there sufficient pre-planning and coordination by the internal auditors with the department before each phase of the internal audit or special project commenced?	<input type="checkbox"/>	<input type="checkbox"/>
Did internal audit discuss its approach and major areas of audit focus with you?	<input type="checkbox"/>	<input type="checkbox"/>
Did you raise any major areas of concern that were not reviewed by the internal audit team?	<input type="checkbox"/>	<input type="checkbox"/>

Comments

Skills and experience

	Yes	No	
Do you consider the internal audit team have sufficient professional experience, project management, inter-personal skills and seniority to effectively carry out the work required?	<input type="checkbox"/>	<input type="checkbox"/>	
Do you consider the internal audit team have sufficient experience in the functional specialisations (eg, IT, risk assessment, treasury) to effectively carry out the work that was required?	<input type="checkbox"/>	<input type="checkbox"/>	
Assess the strength of internal audit's understanding of the organisation and its risk involvement.	Strong <input type="checkbox"/>	Adequate <input type="checkbox"/>	Needs improvement <input type="checkbox"/>
How strongly did the senior members of the internal audit team demonstrate an appreciation of the issues key to your role and responsibilities?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Did members of the internal audit team consistently demonstrate independence in all their deliberations?	Yes <input type="checkbox"/>	No <input type="checkbox"/>	
In your view, does the way in which internal audit is funded impair its independence?	<input type="checkbox"/>	<input type="checkbox"/>	

Do you believe the members of the internal audit team are independent of the activities they audit?

Were members of the internal audit team adequately supervised?

Comments

Work programme

Was effective cooperation achieved between the internal auditors and your department, including the avoidance of undue disruption to normal activities? Yes No

Was there a formal process to determine that internal audit kept you up to date with audit/project progress?

Did internal audit provide early identification and advice of contentious issues, problem areas and delays?

Did internal audit suggest how such issues could be resolved?

Were suggestions realistic, robust and presented clearly and on a timely basis?

How responsive was internal audit to the business's needs, including requests for special investigations? Strong Adequate Needs improvement

Were internal audit reports:

- Relevant, clear and constructive; Yes No
- Sufficiently detailed to enable effective management action;
- Issued on a timely basis?

Were internal audit findings discussed with you prior to being tabled with the audit committee?

Did internal audit follow up recommendations to see whether they had been implemented?

Do you have any major unresolved disagreements with internal audit?

Overall performance

Did internal audit add value to your business? Yes No

In what way did internal audit add value to your business?

Overall comments

Name _____

Signed _____

Position _____

Date _____

Evaluation of internal auditors - External auditors

This checklist should be completed by the external auditor of the parent organisation and of subsidiaries, major business units or regions if appropriate.

Terms of reference

Evaluate internal audit's current terms of reference given your understanding of the organisation's business, complexity, risk environment and the current developments in internal audit.

Strong Adequate Needs improvement

From your knowledge of internal audit and industry best practice, do you consider internal audit's current terms of reference are of appropriate quality?

Yes No

Comments

Skills and experience

Do you consider the internal audit team have the professional experience, technical skills, inter-personal skills and seniority to effectively carry out the internal audit work required?

Yes No

Evaluate the senior members of the internal audit team's understanding of the organisation, its business and its risk environment.

Strong Adequate Needs improvement

Assess the internal audit team's experience in key functional specialisations, in the context of what is needed for the proper discharge of their roles and responsibilities:

- | | | | |
|--------------------|--------------------------|--------------------------|--------------------------|
| ▪ IT; | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| ▪ Risk management; | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| ▪ Treasury; | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| ▪ Accounting; | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| ▪ Tax; | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| ▪ Supply chain. | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |

Other (specify)

From your dealings with members of the internal audit team and your knowledge of internal audit and industry best practice:

- | | | | |
|---|--------------------------|--------------------------|--------------------------|
| | Yes | No | |
| ▪ Do you consider internal audit have sufficient resources to satisfy their terms of reference? | <input type="checkbox"/> | <input type="checkbox"/> | |
| | Strong | Adequate | Needs improvement |
| ▪ Evaluate the sufficiency of internal audit's resources to adequately deliver the services outlined in its internal audit plan in the timeframes identified. | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| | | Yes | No |
| Does the structure of internal audit appear to facilitate a proper understanding of the organisation's business issues? | | <input type="checkbox"/> | <input type="checkbox"/> |
| Does internal audit's staffing appear to adequately reflect its roles and responsibilities? | | <input type="checkbox"/> | <input type="checkbox"/> |
| In your assessment, is the internal audit methodology robust and does it reflect the latest thinking in internal audit? | | <input type="checkbox"/> | <input type="checkbox"/> |

Comments

Work programme

- | | | |
|---|--------------------------|--------------------------|
| | Yes | No |
| Are there regular discussions between internal and external audit on internal and external audit strategies, assessment of risks and the implications of audit findings/audit work? | <input type="checkbox"/> | <input type="checkbox"/> |
| Has progress against plan been monitored jointly by internal and external audit regularly throughout the year? | <input type="checkbox"/> | <input type="checkbox"/> |
| Did you receive copies of all internal relevant audit reports issued by internal audit? | <input type="checkbox"/> | <input type="checkbox"/> |
| Were copies of internal audit reports received on a timely basis? | <input type="checkbox"/> | <input type="checkbox"/> |
| Are internal audit reports of a standard comparable to best practice in other organisations? | <input type="checkbox"/> | <input type="checkbox"/> |
| To the best of your knowledge, are there any major areas of risk or concern that internal audit did not appear to cover? | <input type="checkbox"/> | <input type="checkbox"/> |

Overall comments

Name _____

Signed _____

Position _____

Date _____

Evaluation of internal auditors - Self assessment

This checklist should be completed by the head of internal audit (self assessment).

Understanding

Evaluate internal audit's understanding of:

	Strong	Adequate	Needs improvement
▪ The responsibilities and operation of the audit committee;	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
▪ The organisation's business;	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
▪ The organisation's risk environment;	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
▪ The organisation's control framework.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Comments

Charter and structure

Do the terms of reference for internal audit define in sufficient detail, for the purposes of directing internal audit:

	Yes	No
▪ Roles and responsibilities, including those in relation to other internal functions;	<input type="checkbox"/>	<input type="checkbox"/>
▪ Expectations of management;	<input type="checkbox"/>	<input type="checkbox"/>
▪ Scope of internal audit work;	<input type="checkbox"/>	<input type="checkbox"/>
▪ Access to information?	<input type="checkbox"/>	<input type="checkbox"/>

	Strong	Adequate	Needs improvement
Evaluate internal audit's current terms of reference in light of the organisation's current needs.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Evaluate internal audit's current terms of reference in light of the organisation's future needs.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Assess the structure of internal audit in terms of enhancing its:			
▪ Objectivity;	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
▪ Understanding of the organisation's business issues;	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
▪ Ability to respond to business needs.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Comments

Skills and experience

How well does internal audit's staffing reflect its roles and responsibilities?

Strong

Adequate

Needs improvement

Assess the staff mix and competencies of the internal audit team.

Evaluate internal audit's independence from the activities it audits.

Comments

Communication

Evaluate internal audit's responsiveness to requests from the audit committee, including requests for special investigations.

Strong

Adequate

Needs improvement

Evaluate internal audit's frankness and candour with the committee.

Evaluate internal audit's handling of difficult or contentious issues.

Yes

No

Over the last 12 months, has the chairman of the audit committee been fully briefed on significant findings or developments prior to audit committee meetings?

Evaluate internal audit's process to monitor the status of open matters/recommendations.

Strong

Adequate

Needs improvement

Comments

Performance

This section should be developed to focus on the Key Performance Indicators (KPIs) set for the internal audit team.

In what way has internal audit added value to the organisation?

How would you assess internal audit's overall performance?

Strong

Adequate

Needs improvement

Overall comments

Name

Signed

Position

Date

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KPMG's Audit Committee Institute (ACI)

KPMG's ACI helps to enhance the awareness of effective Audit Committee processes, and provides timely information about relevant corporate governance issues and challenges in many countries and regions around the world. KPMG is the only firm in the Big Four with such a dedicated institute to provide help to Audit Committee members worldwide.

ACI worldwide

Our ACI ensures we have open discussions and up-to-date information for Audit Committee members:

- in 25 countries
- for 1000s of ACI members
- through 100s of workshops, presentations and meetings.

More information: www.kpmg.com/aci

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