How to set up a new internal audit activity

Chartered Institute of Internal Auditors

Establishing a new department, function or activity within an organisation is a major challenge for all those involved. Significant time, effort and resources can be consumed in setting up the new structures, while the expected benefits take time to materialise.

This is also true when establishing an internal audit activity. Internal audit faces additional challenges in that it is not engaged in day to day operations and may require a degree of cultural shift in the organisation before it is seen to be of benefit.

This guide looks at considerations relevant to those involved in setting up an internal audit activity.

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Stakeholder expectations

Undertake stakeholder mapping to know who your stakeholders are.

Stakeholders are both internal and external.

• Internal stakeholders will include the audit committee and board of directors, senior management and employees.
• External stakeholders might include the external auditor, customers, local or national governments and regulators.

Members of the new activity should actively identify and talk to relevant stakeholders at an early stage in the formation process as their views will impact the role of internal audit within the organisation.

Understand their expectations

Each stakeholder will want something different from internal audit. Internal audit should spend time meeting with stakeholders to develop an understanding of their expectations. This will be useful when preparing an internal audit strategy and an initial internal audit plan as it will identify areas
where assurance is required.

Manage expectations
The head of internal audit (HIA) should make clear to stakeholders what the activity can do; and also, what it cannot. For example, the impact of limited resources or activities which might breach independence should be flagged so that stakeholders are not disappointed with the audit plan or outputs.

Maintain communications
The HIA should maintain open channels of communication with all key stakeholders both formally and informally.

Some aspects of this may be a documented requirement, such as regular reporting to the audit committee and meetings with the external auditor. Others, such as the relationship with internal assurance providers or external stakeholders, may not be so regular.

Ongoing contact with all stakeholders will continue to add to the auditor’s knowledge of the organisation, emerging risks and developments in relevant regulation.

Informal contact is also valuable for developing working relationships and should include regular discussions with the chair of the audit committee and audit committee members to reinforce the positioning and the role of internal audit as well as understanding changes in assurance needs.

Structure and governance

Structure
The new internal audit activity must have a clear position within the wider organisational structure. Reporting lines should be clear. The activity should have direct access to the board, audit committee (which will most likely be a committee of the board) and senior members of executive management.

Independence of internal audit must be protected by its place within the organisational structure. This should be clearly set out in a documented charter or terms of reference.

Whilst we refer in this guidance to the HIA working with the audit committee, we acknowledge that in all organisations an audit committee may not have been established. In these instances to ensure organisational independence (Standard 1110) requires the HIA to report to a level within the organisation that allows the internal audit activity to fulfil its responsibilities.

However, the UK Corporate Governance Code 2018, section 4 on Audit, Risk and Internal Control says:

The board should establish an audit committee of independent non-executive directors, with a minimum membership of three, or in the case of smaller companies, two.

Whilst the code applies to listed companies it should be seen as best practice for all organisations.

Governance
The activity will be governed by the internal audit charter. This will document its purpose, authority, roles and responsibilities, rights, place within the organisation, reporting lines, access to
records/personnel/physical properties relevant to the performance of engagements and defines the scope of internal audit activities.

**Assurance and consultancy**
The charter should differentiate clearly between the internal audit activity's role as a provider of assurance and a provider of consultancy services. The former involves objective assessment of evidence to provide an independent opinion; the latter involves providing advice at the specific request of a client.

The nature of assurance services and consulting services must also be defined in the internal audit charter.

**Board approval**
Regular review of the charter will be driven by the HIA but the board (audit committee) has final responsibility for approving the document so there needs to be a timetable for regular review to enable any subsequent amendments.

**Risk maturity**

**Evaluating risk maturity**
The internal audit strategy and approach will be determined by the assessment of the organisation's risk maturity. An organisation which is new to internal audit may be less risk mature and the internal auditor will have to focus on the control processes in place.

In a more risk mature organisation, the internal auditor will be able to look more at the design and application of risk management processes and reporting of risks.

Either way internal audit should seek to periodically express a view to the board on the maturity level of risk management as this will support the organisation's annual governance or control statement.

**Enhancing risk management**
The internal audit activity should, from the time of its creation, seek to contribute to the improvement of the organisation's risk management processes through its consultancy and assurance role.

This can be done by providing advice to the board on risk management processes or performing a benchmarking exercise to identify areas for improvement. Perhaps considering whether the organisation needs to adopt the risk management standard ISO37001?

**Agree priorities and formulate plans (internal audit strategy)**

**Internal audit is part of the organisation**
Directors and heads of department will be expected to formulate a strategy for their area of responsibility which is in line with the organisation's overall strategy. Internal audit is no different and should develop a strategy which is aligned the goals and objectives of the business and to the direction of the business over an agreed timeframe.


**Agree priorities**

The HIA should agree, with the board, audit committee and senior management the key areas where they require assurance and incorporate these into the strategy. Areas of higher risk or priority may be covered a number of times over the strategy’s life cycle.

In addition, the internal audit strategy should explain internal audit’s key objectives and outputs, the approach, methods and resources that will be employed to achieve them with measures of success.

**Risk based audit plan and audit universe**

The HIA must be aware of their responsibility to develop a risk-based internal audit plan. While the input of stakeholders is valuable, the HIA must link the risks impacting upon the organisation to audits which may be completed.

A more risk mature organisation may have developed a risk universe. This is a statement of all relevant risks. This can be linked to an audit universe, which, in turn, is a statement of all audits which might be performed. The HIA should seek to ensure that areas of significant risk including emerging and horizon risks are included in the audit plan.

**Develop the annual plan**

The annual internal audit periodic plan will filter down from the strategy and give a clear indication of the timetable for internal audit work over the course of the coming year.

For internal audit activities that are required to provide an annual report with an overall opinion upon governance, risk management and control the internal audit plans needs to have the required breadth to be able to form such an opinion. This breadth should consider the strategies, objectives and risks of the organisation; and the expectations of senior management, the board and other stakeholders. The strategy and the plan designed to enable an annual opinion should therefore be agreed with the audit committee.

Senior management should also be consulted so that audit work is scheduled appropriately and to establish the relationship between internal audit and other assurance providers (those in the second line of defence, such as risk managers, compliance or health and safety) as this may form part of the strategy and approach to planning leading to the annual opinion. The creation of an assurance map may help support this.

**Expect the unexpected**

New priorities will emerge over time. The annual plan should include space to allow internal audit to meet additional, unexpected requests for work.

**Resources**

**Resources are finite**

The availability of staff resources will determine what can be included within each annual plan. If the audit committee wants extra areas of work to be undertaken, the HIA may have to seek support from third party internal audit providers or consider alternative resources solutions eg guest audit programmes, secondment from within the business, and co-sourcing options.

Internal audit resources should be appropriate. This includes in the areas of knowledge ie skills and
other competencies needed to perform the plan; sufficient ie the quantity of resources needed to accomplish the plan and effectively deployed ie used in a way that optimises the achievement of the approved plan.

**Staff may have limited expertise**
The HIA or members of the team may not have expert knowledge required to undertake particular assignments, for example, specialist reviews in relation to information technology. External support will be required if such reviews are to be undertaken, eg guest auditors, co-source partners. Consideration should be given as to how the team can acquire these skills and address any skills gaps.

**Development of resource**
The internal audit strategy should include staff development needs, such as training and identifying relevant qualifications to enhance the function’s capability over time. Along with a skills/training matrix, this should feed into broader considerations of continuous professional development (CPD), career progression and succession planning.

Staff should also have sufficient knowledge of key information technology risks and controls and available technology-based audit techniques eg data analytics, to perform their assigned work.

**Coordination**
Internal audit needs to coordinate its work with that of other assurance providers and the approach to determine whether these assurances can be relied upon if they form part of internal audit’s annual report and opinion.

The HIA needs to discuss and agree with the audit committee how to identify other assurance providers and their roles in order to avoid duplication of effort. An assurance mapping exercise will be useful in identifying gaps in assurance, but this may require more time to develop beyond the initial set up of the new internal audit activity.

**Procedures**

**Policies and procedures must be developed**
The internal audit activity must have adequate policies and procedures to guide its work. The form, scope and content of policies and procedures will depend on the size of the internal audit activity.

For larger internal audit teams with a wide geographical spread some form of automation of procedures may need to be considered to enhance efficiency and control over individual audit engagements.

**Align policies and procedures with the charter**

Policies and procedures will give members of the team a clear indication of how they should fulfill their role and undertake assignments in accordance with the internal audit charter. One of the ways to do this is to create an internal audit manual that can be used as a training guide as well means of quality control.

**Tools and techniques**
The HIA also needs to consider appropriate tools and techniques as part of the delivery of individual audit engagements. This includes the method for applying sampling and the use of data and
interrogation tools, for example by using computer assisted audit techniques (CAATs).

**Measuring and monitoring performance**

**Key performance indicators (KPIs)**
Internal audit should agree a set of KPIs with the audit committee to allow objective evaluation of the performance and value of the activity. These should include a broad or balanced set of measures to provide a complete overview of performance. Measures should help you achieve your purpose, rather than measuring something just because you can.

For instance, quantitative elements, such as the number of reviews completed against the agreed plan, performance against budgets and recommendations implemented.

Qualitative indicators might include training provided to members of the team and fulfilment of continuing professional development requirements.

**KPIs as targets**
In addition to establishing a monitoring mechanism, KPIs also provide the HIA with a clear set of targets for the activity as a whole. This can be distilled into performance targets for individual members of staff within the activity. However, care should be taken, if poor targets are set this can result in driving the wrong or inappropriate behaviours which could be self-defeating eg using data that can be easily manipulated.

**Regular updates**
The HIA should provide the audit committee with regular feedback on performance against the internal audit plan. This might be included as a standing item on the audit committee agenda.

**Quality assurance**
A quality assurance and improvement programme (QAIP) should be developed and include all aspects of the internal audit activity, ie not just a review of the end to end audit process. Mechanisms for undertaking the QAIP should be built into the internal audit charter, policies and procedures, strategy and plan from the time of the activity's creation. The HIA should provide feedback to the audit committee as to the results of the QAIP, areas of weakness and plans for improvement.

**Conclusion**

While there are a lot of things to do to set up a new internal audit activity it should be approached as a project over a given period of time eg 60 or 90 days so that it is managed in a structured way to increase the likelihood of success.

The same approach can also be applied where a new HIA takes up a new position and is looking to review the current internal audit activity. To aid both these situations here is a checklist of activities for consideration.

**Checklist**
Stakeholders
• identify key internal and external stakeholders
• obtain a clear understanding of their expectations
• explain the role of internal audit - to manage expectation.

Governance
• communication - board, audit committee, senior management
• reporting lines - audit committee, administrative line management.

Standards
• internal audit charter in place - approved by the board/audit committee
• conformance with Institute of Internal Auditors’ International Professional Practices Framework (IPPF).

Strategy
• identification of organisation’s objectives
• preparation of internal audit strategic plan.

Risk
• assessment of organisation’s risk maturity - to determine the internal audit strategy and approach.

Planning
• identification of organisation’s key risks
• assurance mapping to identify gaps in the assurance framework
• agree annual internal audit plan - to be approved by the board/audit committee.

Resources
• agree budgets (financial and staffing)
• consider how department should be resourced (in-house, buy in specialist requirements, etc)
• consider staff development needs - training, continuous professional development, career progression and succession planning
• co-ordinate internal audit work with that of other assurance providers (internal and external).

Procedures
• create policies and procedures - aligned to charter.

Processes
• standard working papers and reporting
• mechanisms and responsibilities for tracking audit findings.
• establish tools for conduct of reviews (sample sizes, data interrogation techniques etc.)
Performance
• agree performance measurement mechanism (internal audit function and team members).

Quality
• build quality assurance and improvement programme into the internal audit strategy.

Download a pdf checklist

Further reading

Standards
1000 - Purpose, Authority and Responsibility
1010 - Recognising Mandatory Guidance in the Internal Audit Charter
1110 - Organisational Independence
1111 - Direct Interaction with the Board
1112 - Chief Audit Executive Roles Beyond Internal Auditing
1130 - Impairment to Independence or Objectivity
1200 - Proficiency and Due Professional Care
1300 - Quality Assurance and Improvement Programme
2000 - Managing the Internal Audit Activity
2010 - Planning
2020 - Communication and Approval
2030 - Resource Management
2040 - Policies and Procedures
2050 - Coordination
2060 - Reporting to Senior Management and the Board
2120 - Risk Management
2450 - Overall Opinions

Supplemental Guidance
Developing the internal audit strategic plan
Quality assurance improvement programme
Reliance by internal audit on other assurance providers

External resources
Financial Reporting Council – The UK Corporate Governance Code 2018