

## Back to Basics

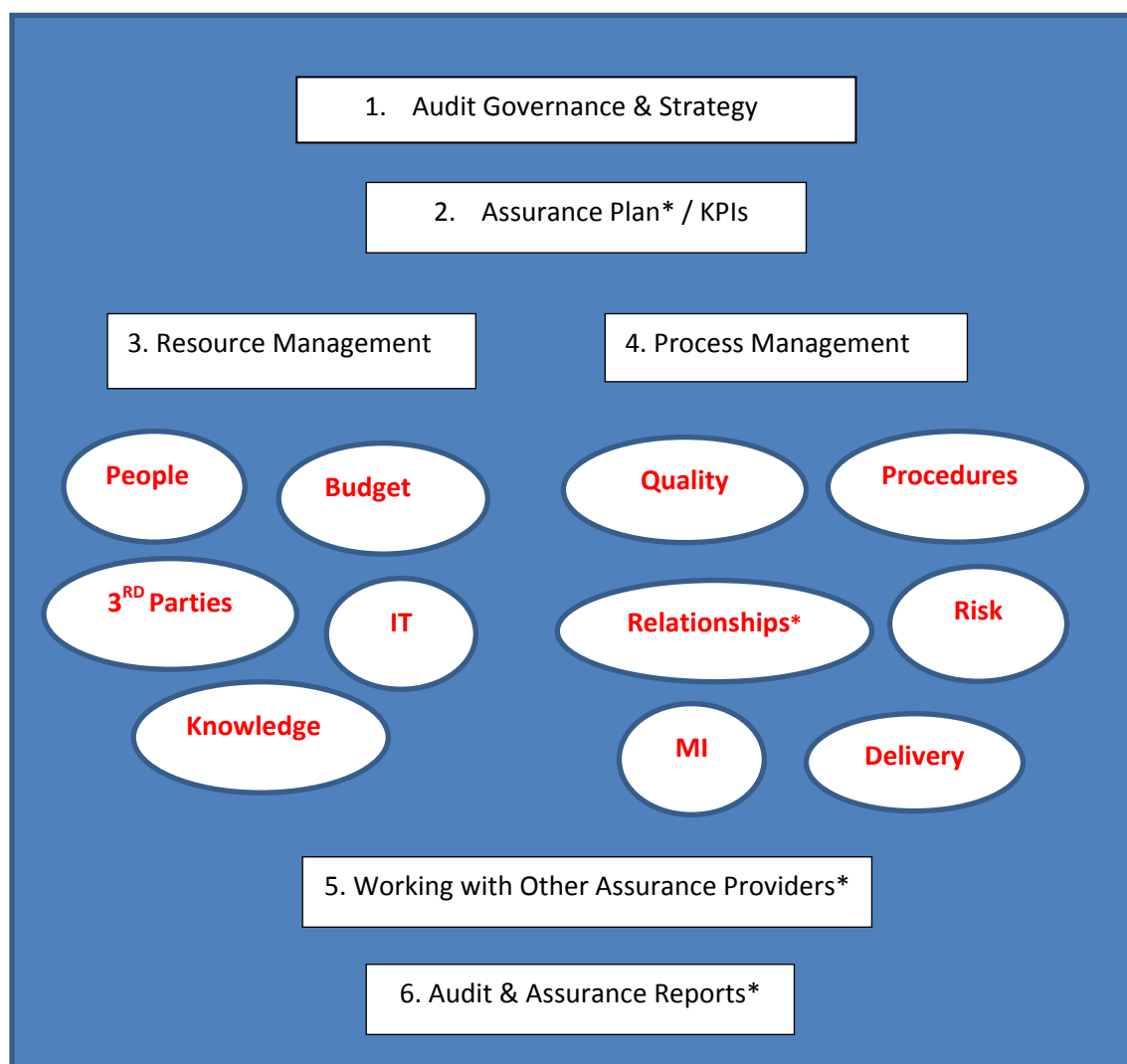
### Managing the Audit Department: An Overview

In this latest article in the Back to Basics series; Bev Cole will be taking us through an overview of the fundamental aspects of managing the audit department. Bev is an independent consultant on Internal Audit and Risk Management, and has worked in these areas within Financial Services for over 20 years.

Managing the Audit Department is obviously a very big subject which can't be covered in just one article. Therefore my primary aim is to provide you with an initial roadmap outlining the fundamental building blocks. We'll then give you more information in this and two subsequent articles. Some of the building blocks are so big that they are covered in an article in their own right, most of which are already published and can be found on the ACCA Internal Audit Virtual Learning Centre.

\*covered in separate articles outside of this series

#### Diagram A: Roadmap for Managing the Audit Department



Performance Standard \*\* 2000 states that “The chief audit executive must effectively manage the internal audit activity to ensure it adds value to the organization”.

Linking to the diagram above, the key questions to ask yourself when managing the department are:

1. What is your purpose and mandate; where are you heading, how will you know if you’ve arrived; and what are your boundaries? This should be set out in the Audit Charter, Audit Strategy and Policies respectively.
2. What are you setting out to achieve? In a technical sense this is the assurance plan\*. However, you should also set out what you want to achieve in terms of your Key Performance Indicators (KPIs).
3. Do you have the right resources at your disposal and are you managing them effectively? This includes all your resources: people; IT; third parties; knowledge; and budgets.
4. Are you directing these resources in the right way and how do you know this? All departments will need: procedures; quality control; performance Management Information (MI) (including feedback); risk management; delivery management; and last but not least guidance on managing relationships\*.
5. Without impacting your independence and objectivity, are you working effectively with other assurance providers?\*
6. What is the output for your stakeholders? This is covered by audit and assurance reports\*.

All of these questions will be of interest to key stakeholders such as the Audit Committee; any Regulator; Executive Management; your line manager; and your audit colleagues. In fact, if you can’t answer these questions as the leader of the department, then you can’t expect your team to follow you or your stakeholders to trust and understand your assurance.

Let’s go through steps 1 and 2 in a bit more detail.

### Step 1 - Audit Governance and Audit Strategy

Audit governance includes your mandate and reporting lines as outlined in the Audit Charter. It also includes how the department manages itself through its own management committee and audit strategy.

#### a) Audit Charter

The Audit Charter is a requirement of the International Standards for the Professional Practice of Internal Auditing\*\*. Attribute Standard 1000 states that “The purpose, authority, and responsibility of the internal audit activity must be formally defined in an

internal audit charter, consistent with the Definition of Internal Auditing, the Code of Ethics, and the Standards. The chief audit executive must periodically review the internal audit charter and present it to senior management and the board for approval.”

It is too easy to just see this document as something required to meet the Standards and to produce it and not use it. However, this is your mandate from the Board and therefore it is a very powerful tool if used correctly. Use it to set out and agree your purpose; what you will undertake and what you won't; your authority; the right of access you have to all books and records; your right of access to senior management and the Board; the professional standards and codes the Department must comply with; your independence and objectivity and how it will be maintained; your duty of care to the business; the nature of assurances to third parties; and how the department's performance will be monitored. Don't forget, this is where you can manage expectations through outlining your goal of providing *reasonable* assurance as opposed to *absolute* assurance.

If you get the Audit Charter right in the first place, you will avoid a lot of debates further down the line. We all know the sorts of things that crop up: whether we should do consultancy work; whether we should be part of decision making within committees; whether we should undertake a line activity; whether a manager can refuse to be audited; whether we can be told to do an audit by the business and whether our judgement can be overridden by management. This is your opportunity to define all of these scenarios up front and agree with the Board the stance you must take in order to be an effective audit department. The precise stance may vary from company to company, but there are some things that audit departments should never, ever do. Your team will definitely thank you for being clear up front and for that fundamental stance being consistent when there is a change in audit leadership.

#### b) Reporting Lines

Reporting lines are often very contentious and also difficult to manage in practice in smaller organisations. In principle, you should try to avoid the situation where you are reporting to someone who is responsible for managing an element of the business. The reason is obvious, how can you be independent and objective – and be seen to be so – if you are directly auditing the person who decides your salary, bonus and often your career prospects? However, we are *Internal* Audit and therefore have to report to someone. The Chairman is a good option, but often a compromise is achieved by reporting to someone for pay and benefits, but with your actual reporting line being the Chair of the Audit Committee. Another compromise is reporting to an executive director, but outsourcing the audits of their other areas of responsibility. Whatever the solution, ensure the audit team are clear that the prime customer of the department is the Audit Committee / Board. Don't forget that within Attribute Standard\*\* 1110 “...The chief audit executive must confirm to the board, at least annually, the organizational independence of the internal audit activity”. It is also important that the chief audit executive interacts directly with the board as per Attribute Standard\*\* 1111.

### c) Audit Strategy

The audit strategy should define where you are aiming to get to as a department and when, where you are now, what the gap is, what your thoughtout plan is for bridging that gap, and how you will know if you've got there. The audit team will back you if they understand why change is needed, where the department is heading and why, and what the individual changes are that will get it there. They will not follow you if all they see are a series of what seem like random changes that do not link together and often fade away. The purpose of the strategy is not the production of a document which gets filed and never seen again: it should be a living document which is used to drive change and improve the department.

### d) Audit Policies

Performance Standard\*\* 2040 states "The chief audit executive must establish policies and procedures to guide the internal audit activity".

So as well as company policies, you should have policies within the department to define the boundaries that you work within. Those policies should be short and to the point, if you are covering more than a page or two then you are probably straying into procedures. Don't forget to include how the policy will be monitored and the sanction in place for breaching the policy. The table below outlines some policies which you may wish to consider:

Policy	Content / Coverage
Conflicts of Interest	What is deemed to be a conflict of interest, who should you report it to and how should you deal with it. Your obligation to ensure independence and objectivity. Acceptance and disclosure of gifts. Refer to Attribute Standard** 1120 on Individual Objectivity and 1130 on Impairment to Independence or Objectivity.
Professional Education	Professional qualifications where study support and continuing professional development (CPD) are supported by the department. Details of study support – study leave, financial support, support for retakes, claw back on leaving the company. Payment of annual fees. Details of CPD support.
Mandatory Training	In addition to mandatory company training, you may wish to require the IPPF Code of Ethics and International Standards** and all audit policies to be read annually by all staff. It is also useful to remind colleagues that they must comply with the CPE requirements of their profession and Attribute Standard** 1230 on CPD. If it is not a mandatory company training requirement, it is also useful to have audit colleagues remind themselves of the Whistleblowing policy on an annual basis. A reminder of the content of the Audit Charter is also useful periodically.
Audit Documentation – Requirements &	The audit documentation that is mandatory. The secure storage of data and of laptops. Compliance with the Data Protection Act

Retention	re the non- identification of individuals within audit testing papers. The length of time that audit documentation should be retained, both hard and soft copy and who is responsible for this.
Travel / Flexible Working	Audit departments often need audit colleagues to travel extensively. Therefore, in addition to any company policy, you may wish to outline flexible working arrangements associated with this, such as time off in lieu or working from home following time away. You would be advised to look at the Working Time Directive requirements as well. If your company expenses policy is not explicit enough to cover arrangements required in Audit, then add policy here as a supplement to it.
Business Continuity Plan	Not a policy as such, but a plan probably required to comply with company policy which all audit colleagues should be aware of. Audit management in particular should ensure they have a copy of the plan offsite and have up to date contact lists for colleagues.

## Step 2 – Key Performance Indicators (KPIs)

(The assurance plan is also within Step 2, but is covered in a separate article on the VLC)

In addition to the assurance plan, you should also define the annual KPIs which will move the department forward in line with the strategy, and then monitor their achievement as an audit management team on a monthly basis.

The KPIs should cover a balanced view of the performance of the department. Expected outputs should be defined and then for simplicity you can rate outputs using a Red Amber Green (RAG) status. Trends in performance are also useful to report. Examples of what could be included are shown below, linking to the roadmap in Diagram A:

<i>Policies</i>	Extent of compliance with policies
<i>Assurance Plan</i>	Progress on delivery of the annual plan
<i>Resource Management:</i>	
People	Turnover % of qualified staff Productivity (in other words, time on audit work vs admin, training etc) Time invested in training Feedback, in other words staff survey results
Budget	Spend vs budget
3 <sup>rd</sup> Parties (in other words, co-sourcing / outsourcing)	Performance against expectations set in the Service Level Agreement / contract
IT	Availability of audit systems
Knowledge	Attendance at key committees and meetings with key

Management	stakeholders
<i>Process Management:</i>	
Procedures	Extent of compliance with procedures
Quality Assurance	Peer rating of quality from a sample of audits External assessments of quality Business feedback – average assessment scores from audits
Relationship Management	Feedback – audit committee & executive management
Risk Management	Compliance with company risk identification, management and reporting requirements
Delivery Management	Delivery of audits within budget (manday & cost) Delivery of audits within target elapsed time
MI	Delivery of MI reports on time and to quality standards
<i>Audit &amp; Assurance Reports</i>	Delivery of audit reports within target elapsed time after completion of testing

So I have now given you an overview of the management of the audit department, provided you with a roadmap to follow and have given you more detail on audit governance, strategy and on annual KPIs. In the next article I will take you through Step 3 on Audit Resource Management.

\*\* For more information on all the standards, please refer to <http://www.iaa.org/>