



Evaluation of the Internal Audit Function

The information contained in this guidance paper is provided for discussion purposes. As such, it is intended to provide the reader and the entity with general information of interest and not to address the circumstances of any particular individual or entity.

The information should not be regarded as professional or legal advice or the official opinion of any of the individual organisations represented on the steering committee of the Public Sector Audit Committee Forum (PSACF).

Although the PSACF takes all reasonable steps to ensure the quality and accuracy of the information, no action should be taken on the strength of the information without obtaining professional advice. The PSACF and the sponsors shall not be liable for any damage, loss or liability of any nature incurred directly or indirectly by whomever and resulting from any cause in connection with the information contained herein.

Introduction

This paper contains guidance over the evaluation of the effectiveness of the internal audit function and contains four sections:

- **Section A – Evaluation by the Audit Committee**
- **Section B – Evaluation by management**
- **Section C – Evaluation by the external auditor**
- **Section D – Evaluation by the CAE – a self-assessment**

The templates provided are by no means exhaustive and further questions related to the specific circumstances of the individual organisation's internal audit activity should be added. The purpose of regularly assessing the internal audit activity is to ensure that issues raised can be addressed by appropriate leadership, thereby increasing the value added by the internal audit activity to the organisation over time.

The conclusions based on the evaluations conducted need to be discussed in appropriate forums, with the Chief Audit Executive ("CAE"), present to ensure that there is clear communication of the achievement of both acceptable and unacceptable performance and guidance is provided where improvements can be made.

This paper should be read in conjunction with the following PSACF papers:

- **The role of audit committees in relation to the external and internal audit process; and**
- **Public Sector Audit Committees' role in overseeing internal audit.**

Applicable internal audit standards

The International Standards for the Professional Practices of Internal Auditing (Standards) that are issued by The Institute of Internal Auditors (IIA) are mandatory guidance for internal audit practitioners as well as internal audit activity. The IIA has developed the globally accepted definition of internal auditing, as follows:

Internal Auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

According to Standard 2000 – Managing the Internal Audit Activity; the CAE must effectively manage the internal audit activity to ensure it adds value to the organization.

Furthermore Standard 2100 – Nature of Work; states that the internal audit activity must evaluate and contribute to the improvement of governance, risk management, and control processes using a systematic disciplined approach.

Applicable legislation

Public Finance Management Act No 1 of 1999 (PFMA)

In terms of section 38(1)(a)(ii) of the PFMA, the accounting officer for a department, trading entity or constitutional institution must ensure that there is maintenance of a system of internal audit under the control and direction of an Audit Committee complying with and operating in accordance with regulations and instructions prescribed in terms of section 76 and 77 of the PFMA.

Municipal Finance Management Act No 56 of 2003 (MFMA)

Section 62 of the MFMA requires amongst others, that the accounting officer of a municipality must take all reasonable steps to ensure that the municipality has and maintains effective, efficient and transparent systems of internal audit operating in accordance with any prescribed norms and standards. Section 165(1) of the MFMA prescribes that each municipality and each municipal entity must have an internal audit unit, subject to subsection (3) which provides that the internal audit function referred to subsection (2), may be outsourced if the municipality or municipal entity requires assistance to develop its internal capacity and the council of the municipality or the board of directors of the entity has determined that this is feasible or cost-effective.

Treasury Regulations

Treasury Regulation section 3.1.10 states that the Audit Committee must, amongst others, review the following:

1. the effectiveness of the internal control systems;
2. the effectiveness of the internal audit function;
3. the risk areas of the institution's operations to be covered in the scope of internal and external audits;
4. the adequacy, reliability and accuracy of the financial information provided to management and other users of such information;
5. any accounting and auditing concerns identified as a result of internal and external audits;
6. the institution's compliance with legal and regulatory provisions; and
7. the activities of the internal audit function, including its annual work programme, coordination with the external auditors, the reports of significant investigations and the responses of management to specific recommendations.

King Report on Governance for South Africa 2009 (King III)

Although King III is not mandatory for the whole public sector, it does provide best governance practice guidance which progressive organisations could implement. Principle 7.1 of King III states that the board should ensure that there is an effective risk-based internal audit function. Principle 7.4 of King III further states that the Audit Committee should be responsible for overseeing internal audit, which includes in terms of paragraph 22 evaluating the performance of the internal audit function every year so as to ensure that internal audit is fulfilling its responsibility to assist and advise the Audit Committee and the board.

Evaluating internal audit effectiveness

In evaluating the effectiveness of internal audit, the Audit Committee needs to assess the effectiveness of internal audit against agreed performance criteria, including:

- compliance by internal audit – be it in-house, outsourced or co-sourced – with its agreed charter or plan/scope and level of performance;
- the overall comprehensiveness of the internal audit plan and its relationship with the strategic objectives of the business;
- delivery of timely internal audit services in accordance with the plan; and
- competency of internal audit staff and adequacy of resources to achieve the scope as outlined in the plan. This may require outsourcing certain specialist skills not available in the internal audit function.

The Audit Committee, should, on an annual basis, request a review of internal audit performance from various sources including management, the external auditor and through a self-assessment.

Evaluation of the internal audit function

This evaluation process focuses on an individual's perception of the internal audit function as a whole; it does not seek to evaluate individuals and their personalities. This guideline is not exhaustive and questions should be added or omitted as is appropriate in the circumstances. In situations where internal audit is outsourced, the Audit Committee should still evaluate the performance of internal audit as well as the senior executive or director responsible for internal audit. The Audit Committee chairman should determine who is asked to complete the questionnaire. The questionnaire should be completed in the following manner:

- The responses should be collected on a Likert scale of 5: 1 for strongly disagree, 2 for disagree, 3 for neither disagree nor agree, 4 for agree and 5 for strongly agree.
- Not Applicable ("N/A") can be used where the evaluator does not have a view on the matter or the question is not relevant to their environment. Comments should be provided in such an instance as to why the question is marked N/A.
- There is space for comments besides each question. The evaluator is not obliged to make comments; however comments do improve the quality of the review and therefore are encouraged.
- All responses to be treated as confidential, unless the individual completing the questionnaire wishes otherwise.
- The outcomes of the evaluation should be discussed in the appropriate forums with the CAE.

Section A - Evaluation by the Audit Committee

This part contains matters for consideration by the Audit Committee prior to feedback from other areas of the organisation. Where Audit Committee members disagree, detailed comments should be obtained.

Question	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree	N/A	Comments
Understanding of role and responsibilities							
1. Internal audit demonstrates that it:							
• Recognises its direct reporting responsibility to the audit committee.							
• Has a firm understanding of the responsibilities and operation of the audit committee, which guides its reporting and interaction with the audit committee.							
• Understands the organisation's business, governance processes, risk environment and internal control framework.							
• Understands its role in the combined assurance model.							
• Coordinates the internal audit plan with that of the external auditors where applicable.							
2. Internal audit's processes are flexible and dynamic in addressing emerging business, operational, compliance, sustainability and assurance needs.							
Charter, structure and positioning							
3. Internal audit operates in terms of a formally defined and approved internal audit charter.							
4. The internal audit charter is reviewed regularly (at least every year).							
5. Internal audit's mandate meets the organisation's current needs.							
6. The internal audit charter is accessible to everyone in the organisation.							
7. Internal audit is (and is perceived to be) independent from management.							
8. The structure, composition and resources of internal audit facilitates:							
• Consistency in the quality of service to the organisation.							
• Understanding of the organisation's business issues.							
9. Internal audit is strategically positioned to achieve its objectives, i.e., it has appropriate status in the organisation evidenced by the following:							
• The CAE has a standing invitation to attend all audit committee meetings.							
• The CAE has direct access to the chairperson of the audit committee.							

Question	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree	N/A	Comments
• The CAE reports functionally to the audit committee.							
• The CAE has a standing invitation to attend executive committee meetings, but is not a member of the executive team.							
• The CAE is appraised formally of the organisation's strategy and performance, through meetings with the chairperson and/or CEO/Accounting Officer and management.							
10. There is sufficient interaction between the audit committee and internal audit, to ensure alignment and coordination with other assurance providers to minimise duplication of efforts.							
Skills and experiences							
11. Internal audit's resources match its role and responsibilities.							
12. On the basis of the work performed by internal audit over the past 12 months, internal audit appears to have the right staff mix and competencies in specialist areas, e.g., IT and treasury and it has the necessary geographical coverage.							
13. The internal audit team has a suitable programme of continuing education in place.							
14. The CAE maintains a Quality Assurance and Improvement Programme (QAIP) covering all aspects of the internal audit function.							
15. Quality assurance review (QAR) performed in the last 5 years.							
Relationship with the audit committee							
16. The CAE attends all the audit committee meetings he/she was invited to attend.							
17. The CAE makes him/herself available for consultation outside of audit committee meetings.							
18. The CAE expresses his/her views in an open manner to the audit committee.							
19. The CAE is able to handle difficult or contentious issues.							
20. Internal audit is responsive to requests from the audit committee, including requests for special investigations.							

Question	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree	N/A	Comments
21. Internal audit reports are of an acceptable quality and are relevant and useful to the audit committee.							
22. Internal audit reports are received timeously by the audit committee.							
Performance and audit plan							
23. The internal audit plan and changes there to are submitted to the audit committee for approval prior to the commencement of the financial year.							
24. The internal audit plan takes the form of an assessment of the risks and opportunities facing the organisation, and:							
• Aligns with the organisation's risk assessment process.							
• Focuses on providing an assessment of the organisation's control environment.							
• Takes cognisance of industry relevant emerging issues.							
• Has regard to the adequacy of resources and skills available to the CAE to execute the plan.							
25. There was evidence of effective coordination of internal and external audit plans to ensure combined assurance.							
26. Based on reports to the audit committee, internal audit:							
• Delivers the services outlined in the plan.							
• Delivers the services in accordance with the agreed timetable.							
• Operates within budget.							
27. Internal audit evaluates the organisation's governance processes, including ethics and provides a source of information, as appropriate, regarding instances of fraud, corruption, unethical behaviour and irregularities.							
28. Internal audit provides an objective assessment of the effectiveness of the risk management and internal control framework.							
29. Internal audit provides a systematic analysis and evaluates business processes and associated controls.							
30. Internal audit provides a written assessment to the board of the effectiveness of the organisation's system of internal control and risk management.							
31. Internal audit provides a written assessment of the effectiveness of the system of internal financial controls to the audit committee.							

Section B - Evaluation by management

This part contains matters for consideration by management (e.g. heads of major business units, chief financial officer). Where state owned entities or municipal entities are subject to internal audit, such entities should consider asking the leaders of the entity for their input. Where management disagree, detailed comments should be obtained.

Question	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree	N/A	Comments
Planning and communication							
1. Internal audit's charter is accessible to everyone in the organisation.							
2. There is adequate communication of the internal audit plan to management after approval thereof by the audit committee.							
3. There is sufficient planning and coordination by internal audit before each phase of the internal audit or special project begins.							
4. Internal audit discusses its approach and major areas of audit focus with management.							
5. All major areas of concern that you had raised were reviewed by the internal audit team.							
Skills and experience							
6. Internal audit has sufficient professional experience, project management, inter-personal skills and seniority to effectively carry out the work required							
7. Internal audit has sufficient expertise in the functional specialisations (e.g., IT, risk assessment, treasury) to effectively carry out the assessment required.							
8. The CAE is considered to have objective standing within the company and is respected.							
9. Internal audit understands the company, its governance processes, risk environment, control framework and opportunities impacting the organisation.							
10. Internal audit demonstrates an appreciation of the issues key to management's role and responsibilities.							
11. Internal audit consistently demonstrates objectivity in all its deliberations and findings.							
12. The members of the internal audit team are adequately guided by their seniors.							

Question	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree	N/A	Comments
Work programme							
13. There is effective cooperation between the internal auditors and the management department, including the avoidance of undue disruption to normal activities.							
14. There is a process to ensure internal audit keeps management up to date with audit project progress.							
15. Internal audit provides early identification and advises of contentious issues, problem areas and delays within the ambit of its duties.							
16. Internal audit suggests practical, realistic ideas on how effective controls may be established.							
17. Internal audit findings contained in the draft reports discussed with management are:							
• Relevant, clear and constructive.							
• Sufficiently detailed to enable effective management action.							
• Issued on a timely basis.							
18. Internal audit findings are discussed with management prior to being tabled at the audit committee and managements responses are incorporated within the report.							
19. Internal audit followed up recommendations to see whether they had been implemented.							
20. There are no major unresolved disagreements with internal audit.							

Section C - Evaluation by the external auditor

This part contains matters for consideration by the external auditor of the organisation. Where external auditors disagree, detailed comments should be obtained.

Question	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree	N/A	Comments
Charter and structure							
1. Internal audit's current charter is appropriate given your understanding of the organisation's business, governance processes, risk environment, control framework and the current developments in internal audit.							
2. From your knowledge of internal audit and industry best practice, internal audit's current charter is maintained at a high quality level.							
3. Internal audit has the seniority to effectively carry out the internal audit work required.							
4. The internal audit methodology is robust and reflects the latest thinking in internal audit.							
Skills and experience							
5. Internal audit and specifically the CAE understand the organisation, its business, governance processes, risk environment and control framework.							
6. Internal audit's experience in key functional specialisations, is appropriate in the context of what is needed for the proper discharge of its role and responsibilities (The functional specialisations listed below are illustrative only and should reflect relevant functional specialisations as appropriate to the entity):							
• IT, including Cyber, BCP, DRP, etc.							
• Risk management.							
• Treasury.							
• Accounting (including IFRS, MCS, GRAP).							
• Taxation.							
• Supply chain.							
• Human resources.							
• Whistle-blowing.							
• Fraud Prevention and Reporting.							
• Compliance with legislation, reporting on performance information and the audit of service delivery?							
• Other (please specify).							
7. From your dealings with internal audit and your knowledge of internal audit and industry best practice:							
• Internal audit has sufficient resources, skills and experience to satisfy its duties in terms of the charter.							

Question	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree	N/A	Comments
• Internal audit's resources are sufficient to adequately deliver the services outlined in its internal audit plan in the timeframes identified.							
• Internal audit's staffing appears to adequately reflect its role and responsibilities.							
Work programme							
8. There are regular discussions between internal and external audit on internal and external strategies, assessment of risks and the implications of audit findings/audit work.							
9. The progress against plan is monitored jointly by internal and external audit regularly throughout the year.							
10. You receive copies of all internal audit reports.							
11. Copies of internal audit reports are received on a timely basis.							
12. Internal audit reports are of a standard comparable to best practice in other companies.							
13. To the best of your knowledge, there are no major areas of risk or concern that internal audit do not appear to cover.							

Section D - Evaluation by the CAE – Self-assessment

This part contains matters for consideration by the CAE as a self-assessment. Where the CAE disagrees, detailed comments should be obtained.

Question	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree	N/A	Comments
Understanding of role and responsibilities							
1. Internal audit understands:							
• The responsibilities and operation of the audit committee.							
• The organisation's business.							
• The organisation's risk environment.							
• The organisation's governance processes and control framework.							
Charter, audit plan and structure							
2. The internal audit charter and audit plan defines in sufficient detail internal audit's:							
• Roles and responsibilities, including those in relation to other internal functions.							
• Strategic positioning and reporting lines.							
• Expectations of management.							
• Scope of internal audit work.							
• Access to information.							
3. Internal audit's current charter is sufficient in light of the organisation's current needs.							
4. The structure of internal audit is appropriate in terms of enhancing its:							
• Independence from management.							
• Objectivity in providing assurance.							
• Understanding of the organisation's business issues.							
• Ability to respond to business needs.							
Skills and experience							
5. The staff mix and competencies of the internal audit team is appropriate to meet its role and responsibilities.							
6. Internal audit is objective to the activities that it audits and independent from management that oversees those activities.							
Communication							
7. Internal audit is responsive to requests from the audit committee, including requests for special investigations.							
8. Internal audit is able to be frank and open with the audit committee.							

Question	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree	N/A	Comments
9. Internal audit is able to handle difficult or contentious issues.							
10. Over the last 12 months, the chairperson of the audit committee was fully briefed on significant findings or developments prior to audit committee meetings.							
11. Internal audit's process to monitor the status of open matters/recommendations reported is adequate.							

References: Adapted from "Evaluation of Internal Auditors – Questionnaire" by the Audit Committee Institute, sponsored by KPMG

Conclusion

Internal audit's role has changed over time; shifting focus between controls compliance and value added consulting. A highly effective internal audit department can be an important resource, helping the committee understand how effectively the organisation is managing its risks, including those relating to financial reporting and compliance. Once the Audit Committee understands the work internal audit is performing, what other work it is capable of doing, and what management's objectives are for internal audit, the Audit Committee can reach consensus of what role internal audit should play to provide maximum organisational value. The Audit Committee must effectively oversee and support the activities of internal audit. The Audit Committee can only rely on internal audit's work and findings if the function fulfils its duties; it is therefore important for the Audit Committee to periodically assess and discuss the internal audits effectiveness.

**Institute of Directors in Southern Africa
PSACF Secretariat**

National Office - Johannesburg | PO Box 908, Parklands 2121 | Johannesburg, South Africa
144 Katherine Street, Sandown, Sandton 2196

Tel: 011 430 9900 | Fax: 011 444 7907 | Email: IoDSA@IoDSA.co.za | Web: www.IoDSA.co.za

