



Internal Audit Function Overview



Overview of an Internal Audit Function

- Generally, there are 2 types of Internal Audits:
 - Operational or Performance Efficiency-type audits
 - Internal Control audits
- Objectives of each type of audit:
 - Operational or Performance Efficiency-type audits:
 - Identify opportunities to improve operations due to the presence of inefficiencies, lack of critical reporting or other operational conditions
 - Internal Control audit:
 - Review existing business processes and transaction controls impacting the financial records of the entity (either directly or indirectly)
 - Consists of performing testing of the various transaction cycles to assess whether controls are functioning adequately
 - Identifies areas to improve existing controls or to implement controls where they are lacking
 - Focus of remaining slides is on this type of audit

Overview of an Internal Audit Function

- Implementation of an Internal Audit Function in an Organization
 - 3 possible approaches
 - All internal resources
 - Outsourced entirely to a qualified third party
 - Hybrid Approach (combination of internal/external) external resources
 - Alternative selected by an entity depends upon:
 - Its size and complexity
 - Audit Committee's confidence in its ability to execute internally
 - Cost/Benefit analysis of utilizing an outside party
- Attributes of each approach
 - Outsource Approach:
 - Self-explanatory
 - Project Specific or Annual program
 - Reports directly to the Audit Committee or its equivalent
 - Prevalent in those organizations desiring an independent review of certain financial reporting areas
 - All Internal Resources:
 - Separate department/group reporting consisting of a Manager and staff (size depends upon the organization)
 - Annual budget and program developed and approved
 - Reports do Audit Committee or its equivalent
 - Can also be leveraged to assist in the entity's Annual Audit by its independent public accounting firm

Overview of an Internal Audit Function

- Attributes of each approach (continued)
 - Hybrid Approach:
 - Uses both internal and external resources
 - External resources are typically engaged for routine testing of major transaction cycles
 - Internal resources focus on complex areas
 - External resources report to internal head of Audit Group (or to Audit Committee if desired)
- Structure and Implementation of an Internal Audit Function
 - Qualifications of Internal Audit Manager:
 - Prior experience in the industry (preferably both in a financial role as well as audit)
 - Industry experience translates into “knowing the ropes”
 - Typically certified as an IA
 - Prior public accounting experience is a plus
 - Solid working experience of internal control reviews and testing
 - Incorporates experience in developing programs and managing engagements of this type
 - Strong communication capabilities
 - Developing an Annual Internal Audit Program
 - 3 Components of an Annual Internal Audit Program
 - Regular routine audits
 - Special Projects
 - Analytical review of monthly financial reporting package

Overview of an Internal Audit Function

- Structure and Implementation of an Internal Audit Function (continued)
 - Developing an Annual Internal Audit Program (continued):
 - Regular routine audits
 - Consist of auditing every transaction cycle/function at least once during a fiscal year
 - Each audit consists of a formal work program with estimated man-hours and costs assigned as well as timing of procedures
 - Annual program is approved by Audit Committee
 - Emphasis is on transaction testing
 - Product or Deliverable is a report to the Audit Committee identifying findings and recommendations
 - Special Projects
 - Could be planned or identified as part of the annual audit program development
 - More often arise as a result of certain unplanned events
 - Assistance to outside auditors falls into this category
 - Regardless of planned or unplanned status, a component of annual budget should incorporate a special projects element
 - Don't want to "short-change" resource needs for regular audit

Overview of an Internal Audit Function

- Structure and Implementation of an Internal Audit Function (continued)
 - Developing an Annual Internal Audit Program (continued):
 - Analytical Review of Monthly financial reporting package
 - Often the source for special project hours
 - Does not replace the responsibility of the financial office of an entity
 - Should be incorporated in the annual internal audit program
 - Where should an organization begin ?
 - Often begin with an entirely outsourced function
 - Allows for an organization to implement the function quickly (versus having to go through a hiring process)
 - Confirms the importance of the role – typically something has occurred within an entity to consider the implementation of an internal audit function
 - Sets a foundation for the future
 - Matures into an Hybrid Approach
 - Initially, the new internal auditor(s) perform the annual transaction testing to get “up to speed” on the organization
 - Outsourcer focuses on special projects and analytical review
 - Ultimate transition into completely internal, if desired
 - Not mandatory
 - Some organizations prefer having an external presence regularly through the fiscal year