



# *Internal Audit Function Overview*

Visit us on the web: [www.fdcpa.com](http://www.fdcpa.com)

Or Call: 888-875-9770



# 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