KPMG

Does your Internal Audit Function have an Effective Quality Assurance Programme?

August 2020

kpmg.com/cn

Demands on internal audit ("IA") functions have never been greater or more complex, with corporate governance, risk management and internal controls under increased scrutiny by regulators and stakeholders alike. IA functions are the last line of defense for any organisation to ensure that these elements are in line with ever increasing expectations. Making sure that audits performed are of high quality is key to ensuring that the function remains relevant to the needs of the business. The Institute of Internal Auditor's ("IIA") International Standards sets out the requirement and expectations on quality assurance for internal audit functions. Whilst financial service audit departments have been on the forefront of dedicated quality assurance programs, in January 2020 the UK *Internal Audit Code of Practice* has further raised the bar by extending their quality assurance guideline to non-financial service sectors. Having a quality assurance function to continuously challenge the effectiveness of IA is expected to be the new normal across audit teams in any sector in the new decade.

> *Institute of Internal Auditors(IIA) Standards and Requirements*
> *IIA standard reference : 1300 - Quality Assurance and Improvement Program*
>
> *The Chief audit executive must develop and maintain a quality assurance and improvement program that covers all aspects of the internal audit activity. The quality assurance and improvement program must include both internal and external assessments. The chief audit executive must communicate the results of the quality assurance and improvement program to senior management and the board.*
>
> **IIA** The Institute of Internal Auditors

What are Heads of IA's key concern on the quality of their audits?

Was the work performed to a high quality, resulting in all key issues identified?

Was the prescribed internal audit methodology fully applied?
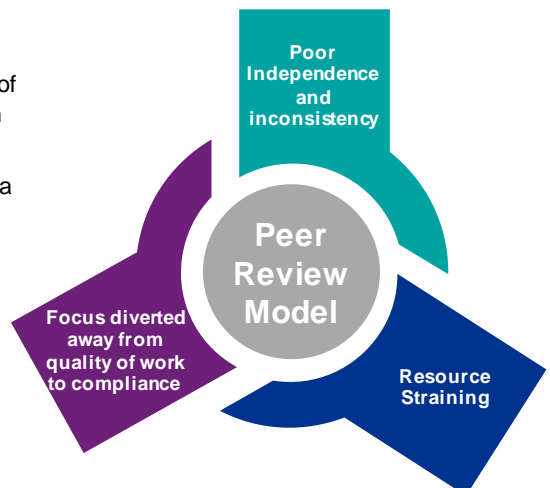
How to drive continuous improvement within the IA function?

Generating insights and improving on these objectives require a quality assurance function that is staffed by suitable senior professionals who are experienced in internal audit leading practices and are proficient in the technical aspects of all subject matter areas of the organisation. This requires significant investment and buy-in from business leaders, which can be challenging.

In practice, access to such experienced resources or the approval of a dedicated headcount to focus solely on quality assurance is often limited. Instead, we find that Heads of Internal Audit often deploy a "peer review" model, where auditors perform quality assurance on each other's work. Such reviews are often performed against a pre-defined checklist or questionnaire that specifies only minimum expectations for audit activities.
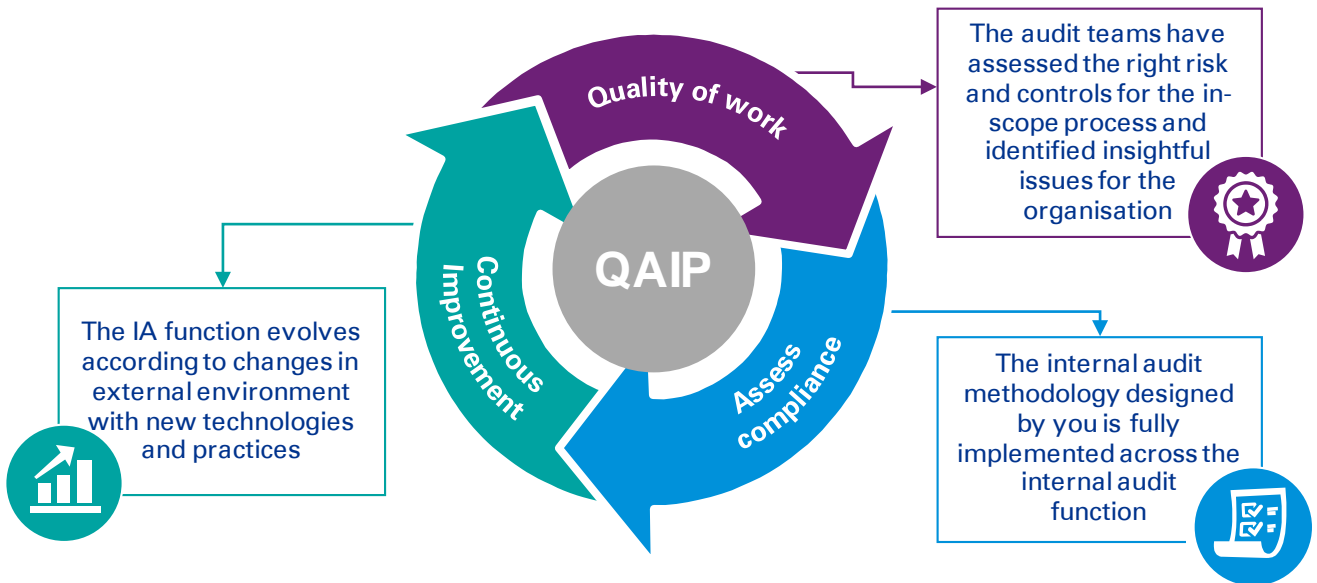
While a peer review model helps overcome some of the cost and headcount restrictions, we find that it poses a number of challenges for Heads of Internal Audit:

Poor Independence and inconsistency

Focus diverted away from quality of work to compliance

Peer Review Model

Resource Straining

A structured approach to quality assurance

A Quality Assurance Improvement Programme ("QAIP") built with the sole focus on assessing whether audit teams are following the IA functions' internal audit methodologies no longer meets the demand of stakeholders. Board of Directors and Audit Committees expect that IA functions are developing along with changing external and internal environment. As such, Heads of IA need to demonstrate additional value on the investments into their quality assurance programme.

To develop an impactful QAIP model, IA function should consider a flexible, cost effective and scalable quality assurance methodology. The methodology should define a complete set of requirements on areas like IA capabilities, technology support and deliverables. This approach requires not just senior internal audit professionals, but also subject matter experts across the key business risks and operational processes, to provide views on the adequacy of audit coverage and quality of work. The desired methodology should be capable of addressing three key objectives for quality assurance:

Quality of work

QAIP

Continuous Improvement

Assess compliance

The audit teams have assessed the right risk and controls for the in-scope process and identified insightful issues for the organisation

The internal audit methodology designed by you is fully implemented across the internal audit function

The IA function evolves according to changes in external environment with new technologies and practices

Quality of work	
Audit Planning and Engagement Scoping	• Have the teams identified the right risks and controls during the scoping phase of audit? • Are prior, ongoing and upcoming audits properly taken into consideration when planning the scope of work?
Quality of Fieldwork Performed	• Is sufficient work performed in accordance with plan to reach a well justified conclusion on the audit area? • Are audit teams using the right data analytics in areas that is viable?
Conclusion-making and Reporting	• Where significant judgements have been applied, have conclusions been reached adequately? • Is the tone of the audit report in line with the issue and audit ratings involved?
Usage of SMEs on Highly Specialised Scopes	• Have the teams consulted subject matter experts at appropriate stages during an audit to ensure industry trends and emerging practices are considered?

Assess Compliance	
Audit Process	• Is the audit process description sufficient as guidance to audit teams?
Gateway and Milestone Approvals	• Are the audit plan, testing and documentation approved by the authorised personnel? • Are teams reporting and seeking consultation from senior management and the audit committee on a regular basis?
Audit Execution	• Have the teams performed the audit work as planned?
Documentation	• Is the documentation of work at re-performance standards? • Is appropriate rationale documented where audit issues are deemed not reportable?

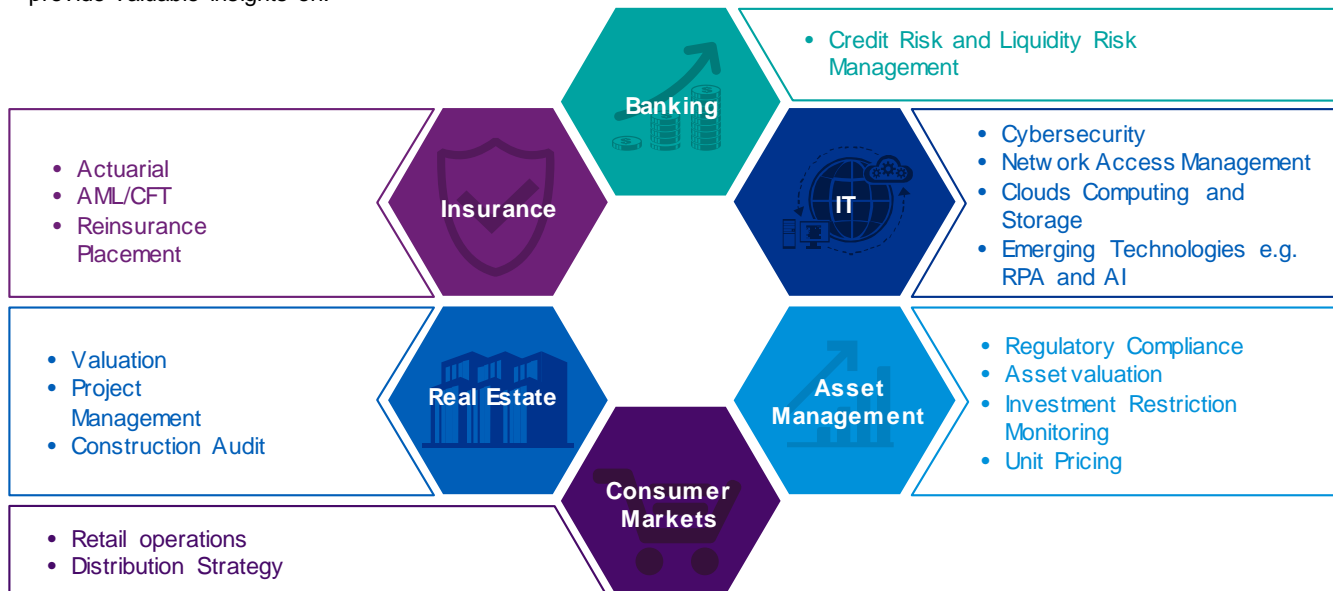| Drive improvement	
Audit Methodology Assessment	• Do you have a robust methodology, approach and templates to cope with the continuous change in external and internal environment?
Audit Data Trend Analysis	• Have you utilised available data to assess the performance of your IA function?
Audit Timeliness and Performance Benchmarking	• How do your audit cycle times compare relative to other market participants? • Do you have the mechanism to identify specific improvement opportunity continuously for your IA function?
Knowledge and Insight Sharing	• Have you organised any sharing session or workshop with the teams to share the key observations and findings from the reviews?

Having the right people is key to success

A peer-review QAIP model with general auditors might work for standard audits. However, it may prove difficult to provide the necessary level of challenge for specialised audit areas, especially on the quality of risks being identified, the appropriateness of changes in scope during fieldwork, the appropriateness of conclusions made on issues identified and final audit ratings. A value adding QAIP would consider the use of SMEs to share industry knowledge and advanced insights on the quality review of specialised audit areas.

According to a KPMG market survey, the following areas are considered the most challenging for quality assurers to provide valuable insights on:

Banking
- Credit Risk and Liquidity Risk Management

Insurance
- Actuarial
- AML/CFT
- Reinsurance Placement

IT
- Cybersecurity
- Network Access Management
- Clouds Computing and Storage
- Emerging Technologies e.g. RPA and AI

Real Estate
- Valuation
- Project Management
- Construction Audit

Asset Management
- Regulatory Compliance
- Asset valuation
- Investment Restriction Monitoring
- Unit Pricing

Consumer Markets
- Retail operations
- Distribution Strategy

Going beyond the traditional QAIP

A traditional QAIP helps to improvement the performance of your internal audit teams. Heads of IA can also utilise the quality assurance function to conduct additional assessments that aim at improving other aspects of the internal audit function. A modern QAIP should be able to provide rich insights to the board or the audit committee, providing them extra comfort that the internal audit function is fully effective as the third line of defense of their organisation:

Additional Data Analysis
- Data analysis on the IA function is as important as embedding data analysis to your internal audit work. Are you using data to actively identify actions for the coming year?

Continuous risk assessment
- If you have a big organisation with different businesses and jurisdiction, you urgently need to launch an on-going assessment for managing various strategic and emerging risks. Are you certain that the internal audit plan is up-to-date and reflective of emerging risk and changes in external environment?

Issue Follow up and Validation Process
- It is important to evaluate whether issues are closed off. Do audit teams sufficiently test and assess managements' remediation actions and identify repeat issues?

Treatment of Repeat Issues
- The problem of repeat issues can be due to multiple reasons. Does your IA function investigate root causes on this holistically and on a per-issue basis?

IA employee survey
- Your audit team is your strongest asset. Do you have good line-of-sight on potential concerns and improvement areas from their perspective?

How KPMG can help?

When conducting Quality Assurance Reviews, our objective is to share our view of leading internal audit practices which reflect your industry, business, size, structure, and most importantly, your goals. We believe that there is not a one-size-fit-all approach to QAIP. We will tailor our service offering to reflect the nature, scale, and complexity of your organisation. Highlights of our service offerings include:

Dedicated KPMG team

QAIP outsource: We can work closely with the Head of IA and provide a tailored quality assurance service leveraging on our proven QAIP approach.

QAIP Advisory: We can review and assess your QAIP against our leading QAIP methodology and benchmark that against participants in the market.

SME file review: Keeping a specialist knowledge pool is resource straining. We can offer SMEs to review and evaluate the specialised audit areas of your organisation.

External Quality Assurance Review: We can independently assess how your IA function meets standards set by the IIA and evaluate your methodology and practices with other organisations of comparable size based on our in-house benchmarking tool against global leaders and your competitors.

Client Success Stories

'Cold Review' Quality Assurance

Client Challenge: This leading audit function in the financial services sector had an established quality assurance function. However, the function lacked comprehensive subject matter expertise to challenge all aspects of audit delivery.

KPMG Solution: We conducted 'cold reviews' on 20% of audits delivered by the client. Applying the KPMG quality assurance methodology and including subject matter experts where required, we were able to effectively challenge audits completed and assess how the client's internal audit methodology was embedded across audits sampled. Using techniques such as data analysis and peer benchmarking, we were also able to identify some key recommendations, which in turn have helped improve the effectiveness and efficiency of the audit process.

Client Benefits: The quality of work for different audit teams have gradually improved over the years, providing comfort to the Audit Committee and Head of IA on the effectiveness of IA in the organisation.

'Hot Review' Quality Assurance

Client Challenge: This client in the technology sector lacked sufficient local regulatory knowledge and needed expert support to make sure their audits were covering the right risks and were being delivered to an appropriate quality.

KPMG Solution: We provided the client with a 'hot review' model to perform on-the-job quality assurance. At the planning phase, we reviewed the client's audit scope, risk and control matrices, and test plans to determine whether all regulatory provisions had been adequately covered. Prior to issuing a draft report, we reviewed the client's fieldwork working papers to assess the depth and quality of audit work. KPMG team worked closely with the audit team to provide continuous feedback on the quality of work at different stage of work.

Client Benefits: This approach has provided the client with an independent assessment over the adequacy and coverage of their internal audits. The focused effort was particularly useful to support the regularity knowledge of a specific team.

Contact us for more information
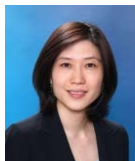
Alva Lee
Partner
T: +852 2143 8764
E: alva.lee@kpmg.com

Jia Ning Song
Partner
T: +852 2978 8101
E: jianing.n.song@kpmg.com

Jeffrey Hau
Partner
T: +852 2685 7780
E: jeffrey.hau@kpmg.com

Jens Kessler
Director
T: +852 2143 8584
E: jens.kessler@kpmg.com

Paul Cheng
Director
T: +852 2847 5075
E: paul.cheng@kpmg.com

Leo Mak
Manager
T: +852 2143 8584
E: leo.mak@kpmg.com

kpmg.com/cn