

A Framework for Audit Evolution

A new capability model identifies the fundamentals needed for effective internal auditing in the public sector.

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PUBLIC SECTOR INTERNAL AUDITING can vary from country to country and even within countries. The overall public sector environment of the country or government where internal auditing is practiced, the organization within which it is situated, and the audit activity itself are all variables that impact the capability of the internal audit activity.

The IIA Research Foundation's recently published *Internal Audit Capability Model (IA-CM) for the Public Sector* is a framework that identifies the fundamentals needed for effective internal auditing in government and the broader public sector. It is intended to be used globally as a basis for implementing and institutionalizing effective public sector internal auditing and as a road map for orderly improvement to strengthen capabilities within internal auditing.

The IA-CM can be used for capacity building, self-assessment, and advocacy. Its primary users include internal auditors and the profession's stakeholders — governing bodies, audit committees, senior management, and external auditors.

THE IA-CM STRUCTURE

The underlying structure of the IA-CM is based on that of a Capability Maturity Model (CMM), which in turn is based on quality management principles. The capability model was developed in part on an adaptation of the Carnegie Mellon Software Engineering Institute's Software Capability Maturity Model and the more recent Technical Report, CMMI for Development, Version 1.2.

The model comprises five progressive capability levels, with each level describing the characteristics and capabilities of an audit activity at that level. The levels illustrate the stages through which internal auditing can evolve as it defines, implements, measures, controls, and improves

its processes and practices. Implementing repeatable and sustainable processes at one level provides the foundation on which to progress to the next level.

- *Level 1, Initial.* No sustainable, repeatable capabilities; dependent on individual efforts.
- *Level 2, Infrastructure.* Sustainable and repeatable internal audit processes.
- *Level 3, Integrated.* Internal audit and professional practices uniformly applied.
- *Level 4, Managed.* Internal auditing integrates information from across the organization to improve governance and risk management.
- *Level 5, Optimizing.* Internal auditing learns from inside and outside the organization for continuous improvement.

The IA-CM also identifies six essential elements for an internal audit activity: services and role of internal auditing, people management, professional practices, performance management and accountability, organizational relationships and culture, and governance structures. Key process areas (KPAs), related to each of the six elements, have been identified for the capability levels. The KPAs are the main building blocks that determine the capability level achieved by the internal audit activity. Each of the 41 KPAs describes a cluster of related activities that when performed collectively achieve a purpose and produce immediate outputs and longer-term outcomes.

DEVELOPMENT

During the IA-CM's development, extensive consultation and interaction took place with internal audit professionals, key stakeholders, and communities of interest around the world. Sixteen internal audit activities in public sector environments participated in on-site IA-CM validation sessions. More than 300 people from over

30 countries were consulted to ensure that the IA-CM was usable, useful, practical, and relevant for public sector audit activities. To further ensure its applicability, an internal audit group in the central government of the United Kingdom recently conducted a self-assessment using the IA-CM.

A SELF-ASSESSMENT TOOL

When the IA-CM is to be used for self-assessment, it is important that those who will be impacted by the exercise understand the structure and underlying principles of the capability model. The chief audit executive (CAE) and internal auditors should familiarize themselves with the model to help ensure they will be committed to the exercise, its results, and an action plan for improvement. There must be clear support and clarity of purpose from the CAE if the intention is to use the IA-CM as an improvement tool.

The team can be of any size. In most instances, the CAE would serve as champion of the self-assessment exercise, and team members would be chosen in consultation with relevant stakeholders. If the team is large or composed of people from a mix of roles (e.g., auditors and management), it may require professional facilitation. At a minimum, the team should include a person skilled in conducting internal or external assessments of an internal audit activity and another person involved in making improvements to the activity.

Stakeholders need to be familiar with the model and understand the value of the exercise. They need to appreciate how the overall environment and organization impact the capability of an internal audit activity and understand that the levels help determine the audit requirements according to the nature, complexity, and associated risks of the organization's operations and identify the appropriate level of audit capability needed. When conducting the self-assessment, the team should:

- Use the model's one-page matrix to identify the KPAs that the audit activity appears to have implemented.
- Obtain and review relevant documentation supporting the implementation of the identified KPAs. This could include documentation relating to the external environment (e.g., legislation, regulations, and external auditor's reports), the organization (e.g., internal control environment and governance structures), and the internal audit

activity itself (e.g., charter, policies, and plans). Sufficient documentation should be obtained to substantiate that the identified KPAs have been effectively implemented.

- Interview managers/stakeholders. Using the one-page matrix, the team should interview relevant senior managers and key stakeholders to obtain their views on the KPAs implemented by internal auditing; whether internal auditing meets their needs in supporting the organization's governance, risk management and control processes; and what improvements, if any, are needed by the internal audit activity.
 - Confirm the actual KPAs implemented and determine the capability level of internal auditing. By reviewing the detailed KPAs — the purpose, essential activities, outputs, and outcomes — the team can determine whether a KPA has been implemented and is sustainable within the audit activity.
- Lastly, the team should communicate results by identifying strengths and areas for improvement and develop an action plan for evolving internal auditing.

APPLYING THE IA-CM

Professional judgment is imperative when using the IA-CM. When developing the model, researchers noted that a less mature internal audit activity might assess itself at a higher capability level — possibly due in part to participants not being fully aware of internal audit professional practices and expectations.

Additionally, the importance of environmental and organizational influences cannot be overemphasized. The IA-CM recognizes how the external regulatory environment and the public sector organization itself may impact the capability of internal auditing. For example, organizational factors such as corporate governance, culture, internal control systems, human resource capacities, and the demand and need for internal auditing must be considered when assessing whether and how a particular KPA is implemented. Environmental factors such as the existence of an effective legal and legislative framework, established financial management and control processes, and a strong human resource component also must be considered. In using the IA-CM, it is important to determine what makes sense and is reasonable considering the organization and environment.

The IA-CM is underpinned by the mandatory guidance (Definition of Internal Auditing, Code of Ethics, and the *International Standards for the Professional Practice of Internal Auditing (Standards)*) included in The IIA's International Professional Practices Framework. An internal audit activity at capability level 3 will generally conform to the *Standards*. While capability levels in the model provide a road map for continuous improvement, an internal audit activity may choose to remain at level 3. However, it is important that it not become complacent at that level. The external environment, the organization's culture and business processes, or the makeup of the internal audit activity may change. Internal auditing needs to ensure that the KPAs, up to and including those in level 3, remain implemented.

Further, internal auditing may choose to stay at a level that is the most appropriate in that organization and environment at that time. It may choose to improve the efficiency and quality of implementation of the KPAs at a particular level rather than striving for and evolving to a higher level.

Internal auditing cannot outpace the maturity of the organization that it supports. For example, to implement KPAs at level 4, such as "Audit Strategy Leverages Organization's Management of Risks," the organization will have had to establish enterprise risk management strategies and practices. At level 5, to institutionalize "IA Recognized as Key Agent of Change," the organization will have to visibly support and commit to endorsing internal auditing's key role in influencing change in the organization. The KPAs in levels 4 and 5 require environmental and organizational influences to effectively institutionalize them into the internal audit activity.

EFFECTIVE INTERNAL AUDITING

The IA-CM can help internal audit activities develop the capabilities necessary for effective internal auditing in the public sector that are appropriate both for their organization and the external regulatory environment. It also will help internal auditing's stakeholders and decision makers understand the important role and value that internal auditing has in public sector governance and accountability.

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