

ASSURANCE – A VITAL TOOL OF GUIDING THE INTERNAL AUDIT

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Abstract

Corporate governance failure, especially within financial institutions, has been at the core of many of the problems during the global financial crises and numerous corporate and organizational scandals and failures. Many subjects have responded by issuing louder calls for increased regulation and by rethinking of guiding tools of internal audit processes like assurance.¹

It is no coincidence that regulatory change in the past decade has focused on the quality of discussion and challenge in the boardroom. We need to understand what drives the organization, what could break it, and what will keep it on track to deliver its goals sustainably. This, in turn, requires an understanding of the assurance – the connection between those who seek assurance and those who provide it. The board is at the top of the network, seeking the assurance to discharge its accountabilities to the organization's external stakeholders "Assurance maps are a vital tool that guide internal audits and give audit committees peace of mind."² In this paper we draw on an attention of key tools in corporate governance practices, especially tool guiding of internal audit.

Keywords: assurance, assurance map, internal audit, financial crisis, corporate governance

JEL Classification: G01, G31, G34, M42

Introduction

For board members, as representatives of good governance, it is important to rethink assurance as the sleepwalking into a disaster is likely to be every company board's nightmare. Reliable assurance cannot be taken for granted. Blind trust at the top is no excuse for not ensuring that the organization's core values and proper conduct are maintained.

Examples ranging from the collapse of Enron to phone hacking at News Corporation and the 2008 financial crisis make it clear that corporate governance has been ineffective when it counted. The assurance given in those boardrooms can only be described as empty. In case of Enron there was considered the board's failure to challenge and seek appropriate assurances from management to have transformed Enron from a well-respected and award-winning company to a disgraced and bankrupt enterprise in less than three months. This was the consequence of not taking steps to become fully informed of the phone-hacking issues and exhibiting willful blindness to what was going on. The culture permeates from the top and reflects the overall lack of effective governance. If boards do not consciously seek assurance, surprises in the boardroom are more likely.

¹ MUCHOVA M., *Basel Committee 2015 Corporate Governance Principles for banks*, Proceedings of Scientific Conference for Doctoral Students and Post-Doctoral Scholarship EDAMBA 2015, pp. 645-653, 2015.

² <http://auditandrisk.org.uk/features/mapping-the-road-to-assurance->

1. INTERNAL AUDIT AND ASSURANCE

The value of internal auditing can be described by these three very important words: assurance, insight and objectivity. Management and governing bodies can look to their internal auditors to provide assurance on whether policies are being followed, controls are effective, and the organization is operating as management intends. Internal auditors have unique insight on which risks might lead to disaster; how to improve controls, processes, procedures, performance, and risk management; and ways to reduce costs, enhance revenues, and increase profits. Internal auditors view the organization with the strictest sense of objectivity that separates them from - but makes them integral to - the business.³

Internal audit is a key source of independent assurance, so it is no coincidence that in the last days the financial services regulators exerted great influence in the development of the IIA's code for effective internal audit in financial services (July 2013). For the code to be implemented effectively, we need to appreciate the assurance network, so that stakeholders work collaboratively across all lines of defense and optimize collective risk intelligence. The code reinforces the link between risk management and risk assurance, and requires a more conscious approach to seeking and providing assurance across the risk spectrum. This link is consistent with the drive in corporate governance to align risk management and assurance across boundaries, and these expectations are found in the emerging practices of integrated assurance. Whether these help to minimize gaps and duplication in assurance plans or facilitate discussions about risks and the control environment, integrated assurance is encouraging a more conscious approach – and internal auditors have an opportunity to be the guiding light.

1.1 Quality Management in Internal Audit

Internal audit should employ both internal and external quality assurance tools in order to ensure that it is delivering an adequate level of quality. A feedback procedure should be implemented within the auditing organization in order to establish an open dialog with managers in audited units. Quality self-assessment processes ensure that every member of the audit organization is involved in the quality assurance process.⁴

The assurance is one of the trends in processes of internal audit. In fact, the lines that such a process should follow have not yet been clearly established because the responsibility of the internal auditor shifts from the verification of purely quantitative data after the fact to providing assurance on the management and disclosure processes that the organization has followed with regard to the issue of materiality. In future the abilities and experience of internal auditors shall be called on to make a contribution and provide support for issuing assurances on social and environmental aspects as well.⁵

2. ASSURANCE MAPPING

Internal audit functions work within organizations to support the improvement of governance, risk management, and control processes. Achieving success requires collaboration between internal audit and management, as well as other internal and external assurance providers. It is unlikely that the internal audit function would have sufficient resources to provide assurance

³ https://na.theiia.org/about-ia/PublicDocuments/PR-Value_Prop_Bro-FNL-Lo.pdf

⁴ European Confederation of Institutes of Internal Auditing, *The Role of Internal Audit in Corporate Governance in Europe*, E.Schmidt Verlag, GmbH & Co., pp. 36-37, ISBN: 978 3 503 10056 9, Berlin, 2007

⁵ European Governance, 2014, *The Official Magazine of the ECIIA*, May 24, 2014, Issue 26, <http://www.interniaudit.cz/download/ECIIA/ECIIA-Magazine-May-2014.pdf>

over the entire organization. Regardless, there are efficiencies to be achieved in coordinating assurance. Assurance mapping can help joint the dots between the activities of each of the different assurance providers, avoiding duplication while maximizing the use of organizational resources.⁶

Internal auditors need to embrace and effectively utilize the valuable data they spend their time producing. This data can be used to draw up maps that guide audits and give management and committees’ clear insight into what controls are being overseen and to what extent. The internal audit team can all use an assurance map for both individual audit planning and to inform the overall audit plan. Use the required level of assurance from the audit committee as a starting point. Either use existing planning methodologies to devise the internal audit plan, map the plan to the assurance map’s required coverage levels for Level 1 and Level 2 Risks, produce a gap analysis and update the internal audit plan accordingly; or produce the internal audit plan directly from the assurance map’s required coverage levels. In the second method, caution is advised to continually update both the assurance map and internal audit plan to take into account emerging risks. To inform individual audits use the relevant Level 3 Risks around which to plan testing.

Assurance maps could work in different forms. In recent years they have developed as audit committees seek to gain assurance that key risks facing the business today and tomorrow are being sufficiently assessed by its assurance providers. For those who are unfamiliar, an assurance map essentially consolidates information from assurance providers and shows how much coverage they are providing over the risks faced by an organization. The assurance map concept transcends industries, institutions, banks and sectors and is a useful tool that can be integrated into internal audit methodologies. The term of “assurance map” is familiar to many, the information they contain differs and some may be easier to use than others.

With the use of big data ever expanding, an assurance map can be a way of utilizing the valuable information created by internal audit and other assurance providers. It presents information in a way that is quick to understand and provides a basis on which to formulate good quality questions from its readers. The answers to those questions can then be used to direct resource to optimum effect, provide more targeted assurance and add long-term value to an organization. Table 1 shows an assurance map with ratings associated with the level of coverage provided; black signifies coverage above the required level defined.⁷

Table 1 – Assurance map: Coverage

	Coverage						
L1 Risk	Strategic Objectives are not met						
L2 Risk	Strategic Projects are not delivered on time			Strategic Projects are not delivered to budget		Strategic Projects do not deliver required outcomes	
L3 Risk	Delays are sustained in resourcing Projects	Delays are sustained in obtaining required technology	Delays are sustained in developing required technology	Delays result in cost overruns	Costs per unit is greater than forecast	Targed service levels are not achieved	Targed cost savings are not achieved

Source: Dawson, S. (2016)

⁶ PITT S.-A., *Internal audit quality – Developing a Quality Assurance and Improvement Program*, John Wiley & Sons, Inc., Hoboken, pp. 97-103&213-215, ISBN 978-1-118-71551-2(hardback), New Jersey, 2014
⁷ This contribution is the result of the project VEGA 1/0124/14 „The Role of financial institutions and capital market in solving problems of debt crisis in Europe”.

In risk mature organizations where assurance maps have been widely used to show coverage they can be further developed to show results, as shown in Table 2.⁸

Table 2 – Assurance map: Results

	Results						
L1 Risk	Strategic Objectives are not met						
L2 Risk	Strategic Projects are not delivered on time			Strategic Projects are not delivered to budget		Strategic Projects do not deliver required outcomes	
L3 Risk	Delays are sustained in resourcing Projects	Delays are sustained in obtaining required technology	Delays are sustained in developing required technology	Delays result in cost overruns	Costs per unit is greater than forecast	Targed service levels are not achieved	Targed cost savings are not achieved

Source: Dawson, S. (2016)

2.1 Developing an assurance map

To develop a comprehensive assurance map we will need to have an understanding of and liaise with our organization's other assurance providers. This will include designated first line control functions and second line functions such as risk management and regulatory compliance. Also we will need to agree upon the framework to use to structure the assurance map information – the risk universe, audit universe or something new. The most appropriate choice will likely depend upon the organization's risk maturity. This will be used as our basis for assessing coverage.

Using output from all assurance providers, ascertain which controls have been tested and to what extent. Doing this for each and every risk/control will take some time and, depending upon your methodology, may involve going through individual test programs.

The ratings are an effective way of giving your assurance map the most visual impact; these are generally widely used, familiar and easily understood. Perhaps add an additional color (grey as an example) for coverage beyond that desired - this is potentially wasted resource that could be better utilized elsewhere. Our black areas could help address our red ones.

Decide how much assurance coverage we or the audit committee require over each risk. For risks with a lower risk appetite we may choose to require 100 per cent - for example there may be low (or more likely any) risk appetite for regulatory or legal breach. Conversely, for risks with a higher risk appetite we may say that 20 per cent is sufficient.

3. VALUE-ADDED ASSURANCE

An assurance map can provide a basis on which to communicate with stakeholders and begin quality conversations. An assurance map can help risk committees and audit committees understand current assurance positions, highlighting areas of low coverage, extensive or over coverage and gaps in understanding. One example of this would be an assurance map showing a huge amount of coverage by internal audit, but none from the second line, which leads to the

⁸ This contribution is the result of the project VEGA 1/0124/14 „The Role of financial institutions and capital market in solving problems of debt crisis in Europe”.

question: why? There may be valid reasons for this and some qualitative commentary will be required.

If we are able to cross-reference the assurance map results to the risk events log this could reveal that one of the causes for a greater concentration of risk events in one area has been a historic lack of assurance coverage. In which case a higher level of coverage could be beneficial or this could direct the audit committee to consider whether first line management are effectively taking second and third line recommendations on board. On the other hand if an area with recent risk events is shown to have a significant amount of coverage, then the audit committee may want to initiate a deeper investigation into the cause of this. We can provide the first line management with an assurance map specific to their area to allow them to see the results of assurance providers' testing and compare it to their own results. It will help them to see pictorially the results of second and third line assurance activity and can help them direct their resources to areas of concern. Regardless of the types of assurance engagements undertaken by the internal audit function, value is achieved when assurance moves beyond the adequacy of individual controls to the overall adequacy of systems and processes.⁹

Conclusions

Finding the right balance between the internal audit function assurance services and consulting engagements requires an explicit strategy that should be determined by the audit committee or equivalent on behalf of the organization. The audit committee determines how much assurance is needed in each engagement, plans it appropriately, and finds the right resources to complete the task. Consulting and assurance engagements of internal audit functions are important and valuable to an organization.¹⁰

The conclusion of studies on corporate failures has been consistent. Unfortunately, the failure has to learn from these. It is time to rethink assurance in the governance process – from being intuitive to being conscious. This rethink is particularly pertinent as organizations experience greater change and complexity in their structures and business models.

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