



### Consulting Services Performed by Internal Audit

The concept of internal auditors acting as consultants within the companies that employ them or contract with their external firms seems to be a natural use of resources which may have company-wide depth and breadth of knowledge to perform such services in a beneficial manner to the client. The question is whether such consulting services affect or violate the independence of the internal auditors who may eventually be auditing areas, policies, procedures, controls or any other functions for which they advised company management.

The Institute of Internal Auditors (“the IIA”) is “an international professional association which is the internal audit profession’s global voice, recognized authority, acknowledged leader, chief advocate and principal educator.”<sup>1</sup>

The IIA provides professional guidance to internal auditors (both members and non-members of the organization). The IIA updated its professional guidance in its International Professional Practices Framework (IPPF) in October 2008 and these standards are effective beginning 2009. The IPPF “is the conceptual framework that organizes authoritative guidance promulgated by The Institute of Internal Auditors.”<sup>2</sup>

The IPPF provides guidance on many topics related to internal auditing. It also provides a standard definition of internal auditing stated as:

“Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.”<sup>3</sup>

As noted in the IPPF definition above, internal auditing includes “consulting activity.” Clearly the writers of this framework considered, and ultimately concluded, that consulting is an appropriate activity within internal auditing by including it in the definition.

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<sup>1</sup> <http://www.theiia.org/theiia/about-the-institute/>

<sup>2</sup> <http://www.theiia.org/guidance/standards-and-guidance/>

<sup>3</sup> <http://www.theiia.org/guidance/standards-and-guidance/ippf/definition-of-internal-auditing/>

More specifically, the glossary for the IPPF standards includes a definition for consulting services as follows:

“Advisory and related client service activities, the nature and scope of which are agreed with the client, are intended to add value and improve an organization’s governance, risk management, and control processes without the internal auditor assuming management responsibility. Examples include counsel, advice, facilitation, and training.”<sup>4</sup>

There are many specific standards within the IPPF which address many areas including attribute and performance standards applicable to internal auditing. The IPPF standards are considered mandatory guidance for internal auditors.

Consulting services are referred to numerous times within the IPPF standards as a legitimate internal audit activity. There are specific references in the standards which need to be considered or addressed to comply with the standards.

IPPF Standard 1000 requires that the Purpose, Authority and Responsibility for internal audit activities be defined in an internal audit charter. This charter should be reviewed and approved by senior management and the board.<sup>5</sup>

In regard to consulting, Standard 1000.C1 specifically states that the nature of consulting services must be defined in the internal audit charter.<sup>6</sup>

First, in order to comply with this standard, it is assumed that every company with an internal audit group has an internal audit charter which formalizes the function and has been appropriately approved as indicated above.

Second, the charter must include reference to consulting services as a defined activity of internal auditing. As to the nature of services, examples can be provided but should include an appropriate caveat for the examples such as “including but not limited to.” If this has to be edited into the charter, it should be reviewed and approved by senior management and the board at the next appropriate opportunity.

Standard 1120 requires that “internal auditors have an impartial, unbiased attitude and avoid any conflict of interest.”<sup>7</sup> The following standard, 1130, states that, “if [the auditor’s] independence or objectivity is impaired in fact or appearance, the details of the impairment must be disclosed to appropriate parties.”<sup>8</sup>

The example in the standards refers to the need to avoid assurance services in an area of a company in which he/she had operational responsibilities within the previous year.

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<sup>4</sup> <http://www.theiia.org/guidance/standards-and-guidance/interactive-ippf/>

<sup>5</sup> Ibid

<sup>6</sup> Ibid

<sup>7</sup> Ibid

<sup>8</sup> Ibid

Such issues need to be communicated to the client and, as appropriate, to senior management and the board.

However, consulting services in such an area would be permissible. Likewise, if the auditor's independence or objectivity is believed to be impaired in an area to be provided consulting services, disclosure to appropriate parties, as noted above, would be required.

Standard 1210 defines proficiency for internal auditors in terms of skills and knowledge to perform an engagement. A sub-standard, 1210.C1 does state that a consulting engagement should be declined, or that competent advice must be obtained if the staff involved do not possess the skills, knowledge or competencies to perform the all or part of the consulting engagement.<sup>9</sup>

It would seem obvious and not require stating, but no auditor should be assessing or consulting in an area or function of a company in which he/she does not have the appropriate skill sets to perform the work.

Due Professional Care is addressed in Standard 1120. The standard specifically addresses the cost of the consulting engagement relative to the potential benefits.<sup>10</sup>

The standard also applies to internal audit engagements and should be a common sense benchmark for any engagement that the costs should not exceed the benefits or potential benefits.

Performance standards are also included in the IPPF and Planning is Standard 2010. The planning standard addresses the development of an annual audit plan. Consulting services, if known at the time of the plan development, should be considered for inclusion in the plan "based on the engagement's potential to improve management of risks, add value, and improve the organizations' operations."<sup>11</sup>

This standard again reinforces the propriety of consulting services by internal auditors while considering them in context of a risk-based plan, as should be the case with the internal audits in the proposed audit plan.

Improving the governance of the company by the activities of internal audit function is addressed by Standard 2110. A sub-section of this standard notes that "consulting engagement objectives must be consistent with the overall values and goals of the organization."<sup>12</sup> Accordingly, one of the focuses of consulting services should be the same as assessment engagements – how to increase the effectiveness and efficiency of corporate governance.

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<sup>9</sup> Ibid

<sup>10</sup> Ibid

<sup>11</sup> Ibid

<sup>12</sup> Ibid

Likewise, the risk management processes within a company should be a focus for improvement by the internal audit function. Standard 2120 refers to the improvement of the risk management process through internal audit activities.<sup>13</sup> Consulting engagements should also have this objective and several sub-sections of this standard refer to this. Auditors should be alert to risk issues during consulting engagements as well as utilize the knowledge of risks gained during the consulting services in regard to their evaluation or assessment of risk management throughout the company.

The consideration of controls within internal audit activities as stated within Standard 2130.<sup>14</sup> This standard has very similar sub-sections to risk management (Standard 2120) as noted just above. The auditor performing the consulting engagement should “be alert to significant control issues” and should utilize the knowledge of controls gained during the consulting services in their evaluation of controls in other parts of the company.

Engagement planning is Standard 2200. This standard address several issues related to consulting engagements. First, it states that “internal auditors must establish an understanding with consulting engagement clients about objectives, scope, respective responsibilities, and other client expectations.”<sup>15</sup>

Second, the standard notes that “consulting engagement objectives must address governance, risk management, and control processes to the extent agreed upon with the client.”<sup>16</sup>

Further sub-sections state “if significant consulting opportunities arise during an assurance engagement, a specific written understanding as to the objectives, scope, respective responsibilities, and other expectations should be reached and the results of the consulting engagement communicated in accordance with consulting standards.”<sup>17</sup>

And “in performing consulting engagements, internal auditors must ensure that the scope of the engagement is sufficient to address the agreed-upon objectives. If internal auditors develop reservations about the scope during the engagement, these reservations must be discussed with the client to determine whether to continue with the engagement.”<sup>18</sup>

To summarize this standard, any consulting engagement should be clearly defined, communicated to, and agreed upon by management of the area or function. If the opportunity for consulting services becomes evident during audit services, a separate engagement should be planned and executed. Lastly, if the auditors become

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<sup>13</sup> Ibid

<sup>14</sup> Ibid

<sup>15</sup> Ibid

<sup>16</sup> Ibid

<sup>17</sup> Ibid

<sup>18</sup> Ibid

uncomfortable with the scope of consulting services, the auditor and the client should determine if the consulting services should cease.

The work programs can vary for consultative services depending upon the type of engagement according to Standard 2240. Since the scope of services is subject to the agreement of the client, the variations of work programs is unlimited.<sup>19</sup>

IPPF Standard 2330 addresses the documenting information related to internal audit activities. This standard provides guidance for the custody, retention and access to audit records. Sub-standard 2330.C1 specifically addresses the documentation related to consulting services noting that internal audit “must develop policies governing the custody and retention of consulting engagement records.”<sup>20</sup> The implication is that such records may not be addressed by policies for records related to assurance services.

Standard 2410 relates to communicating with the clients of internal auditing services. A sub-section of the standard addresses communication specifically for consulting services. As noted above in the nature of work programs for consulting services, the nature of communicating the progress and results with a client of consulting service may “vary in form and content.”<sup>21</sup> The scope and objectives of consulting services, as agreed upon with the client, may help shape and define this communication which may be substantially different than the traditional audit report.

Disseminating the results of consulting service is addressed by Standard 2440. The standard notes that internal audit is responsible for providing the results of consulting services to the clients. The standard also goes on to state that, if the results of consulting services include significant “governance, risk management or control issues,” the results “must be communicated to senior management and the board.”<sup>22</sup>

Monitoring results is the subject of Standard 2500. Just as internal audit has the need to follow up on issues identified during assurance services, issues resulting from consulting services need to be monitored. Since the nature and results of consulting services may not result in issues which must be addressed or corrected, this standard provides a variation in its description of monitoring related to consulting services. A sub-section notes that internal audit “must monitor the disposition of results of consulting engagements to the extent agreed upon with the client.”<sup>23</sup>

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<sup>19</sup> Ibid

<sup>20</sup> Ibid

<sup>21</sup> Ibid

<sup>22</sup> Ibid

<sup>23</sup> Ibid

## Conclusion

The definition of internal auditing has been documented in current and authoritative guidelines with consulting services stated as an acceptable and appropriate activity within the internal audit function.

Clearly, with all of the specific references to consulting in the new IPPF standards, the subject has been given the full consideration of the authors of the framework. There are numerous areas of guidance provided specifically for consulting services which must be addressed including:

- Audit charter considerations
- Inclusion in the audit plan
- Objectivity and independence
- Impairment of independence
- Proficiency of staff
- Due professional care
- Appropriate planning including objectives and scope
- Alignment with corporate goals
- Identification of risks and controls
- Work programs
- Documentation retention and access
- Communication of results

If the internal audit staff follow and comply with the mandatory standards related to consulting services, as well as any other standards applicable to all services provided by internal audit, there should be no issues providing consulting services to clients. As with any engagement, clear communication before, during and after, as well as appropriate planning and scope definition, should help ensure that the services result in a beneficial and satisfactory product for the client and a strengthened professional relationship between internal audit and operating management.

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