Internal Auditing Guidelines

Recommendations on Internal Auditing for Lottery Operators

Issued by the WLA Security and Risk Management Committee
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Foreword

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. Internal audit activities are performed in diverse legal and cultural environments; within organizations that vary in purpose, size, complexity, and structure; and by persons within or outside the organization. While differences may affect the practice of internal auditing in each environment, compliance with the International Standards for the Professional Practice of Internal Auditing is essential if the responsibilities of internal auditors are to be met. If internal auditors are prohibited by laws or regulations from complying with certain parts of the Standards, they should comply with all other parts of the Standards and make appropriate disclosures.
1. Introduction

1.1 Purpose

This document is for guidance only. The purpose of the WLA Internal Auditing Guidelines is to assist lottery organizations performing Internal Auditing with proficiency and due professional care. These guidelines are designed to reflect worldwide trends, best practices and Professional proficiency in Internal Auditing. It does not constitute a Security Control Standard and cannot be included within the scope for assessment of controls against the WLA security certification process.

1.2 Legal Compliance

Lottery organizations should be aware that jurisdictional laws and regulations exist in most cases and the WLA strongly encourages its member organizations to carefully review and consider these requirements. In cases where contradictions between applicable laws or regulation and the contents of these guidelines exist, applicable laws and regulation shall always take precedence.

1.3 References with other documents

The WLA Internal Auditing Guidelines are based on input from the WLA Security and Risk Management Committee and WLA members as well as from The Institute of Internal Auditors (IIA) and the Information Systems Audit and Control Association (ISACA).

1.4 How to use this document

The WLA AML Guidelines are intended for use primarily by lottery organizations. It is recognized that a “one-size-fits-all” approach may not be appropriate for the entire lottery industry due to the diversity of games and sales channels. Each jurisdiction should therefore consider the specific nature of its business, organizational structure, type of customers and transactions, etc. when implementing the suggested measures and procedures to ensure that they are effectively applied. The main principle is that a lottery organization should be able to satisfy itself that the measures taken are appropriate, adequate and follow legal and regulatory requirements.
2. The basics on internal auditing

2.1 What is internal auditing?

Performed by professionals with an in-depth understanding of the business culture, systems, and processes, the internal audit activity provides assurance that internal controls in place are adequate to mitigate the risks, governance processes are effective and efficient, and organizational goals and objectives are met.

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.

Independence is established by the organizational and reporting structure. Objectivity is achieved by an appropriate mind-set. The internal audit activity evaluates risk exposures relating to the organization's governance, operations and information systems, in relation to:

- Effectiveness and efficiency of operations.
- Reliability and integrity of financial and operational information.
- Safeguarding of assets.
- Compliance with laws, regulations, and contracts.

Based on the results of the risk assessment, the internal auditors evaluate the adequacy and effectiveness of how risks are identified and managed in the above areas. They also assess other aspects such as ethics and values within the organization, performance management, communication of risk and control information within the organization in order to facilitate a good governance process.

The internal auditors are expected to provide recommendations for improvement in those areas where opportunities or deficiencies are identified. While management is responsible for internal controls, the internal audit activity provides assurance to management and the audit committee that internal controls are effective and working as intended. The internal audit activity is led by the chief audit executive (CAE). The CAE delineates the scope of activities, authority, and independence for internal auditing in a written charter that is approved by the audit committee.

An effective internal audit activity is a valuable resource for management and the board or its equivalent, and the audit committee due to its understanding of the organization and its culture, operations, and risk profile. The objectivity, skills, and knowledge of competent internal auditors can significantly add value to an organization's internal control, risk management, and governance processes. Similarly an effective internal audit activity can provide assurance to other stakeholders such as regulators, employees, providers of finance, and shareholders.

As primary body for the internal audit profession, The Institute of Internal Auditors (IIA) maintains the International Standards for the Professional Practice of Internal Auditing
and the profession's Code of Ethics. The Information Systems Audit and Control Association (ISACA) sets forth its Code of Professional Ethics to guide the professional and personal conduct of members of the Association and/or its certification holders.

2.2 Why should an organization have internal auditing?

A cornerstone of strong governance, internal auditing bridges the gap between management and the board, assesses the ethical climate and the effectiveness and efficiency of operations, and serves as an organization's safety net for compliance with rules, regulations, and overall best business practices.

Management is responsible for establishing and maintaining a system of internal controls within an organization. Internal controls are those structures, activities, processes, and systems which help management effectively mitigate the risks to an organization's achievement of objectives. Management is charged with this responsibility on behalf of the organization's stakeholders and is held accountable for this responsibility by an oversight body (e.g. board of directors, audit committee, elected representatives).

A dedicated, independent and effective internal audit activity assists both management and the oversight body (e.g. the board, audit committee) in fulfilling their responsibilities by bringing a systematic disciplined approach to assessing the effectiveness of the design and execution of the system of internal controls and risk management processes. The objective assessment of internal controls and risk management processes by the internal audit activity provides management, the oversight body, and external stakeholders with independent assurance that the organization's risks have been appropriately mitigated. Because internal auditors are experts in understanding organizational risks and internal controls available to mitigate these risks, they assist management in understanding these topics and provide recommendations for improvements.

Organizations which do not have an internal audit function are therefore missing out on the valuable benefits that professional internal auditors provide. In addition, they are also running the risk of relying on management who may not be in the best position to provide skilled, independent, and objective opinions on internal controls. Some organizations assign internal auditing on a part-time basis to an existing staff member who has other responsibilities. When this occurs, the person does not have the professional internal audit training or experience necessary for optimal effectiveness. Such organizations run the risk of poorly performed audits and reviews, and this individual, who may be relatively junior in the organization, may lack the organizational status and stature to achieve positive results. In this environment, high-risk processes may not be identified for reviews and serious internal control deficiencies may be overlooked.
A primary lesson from the financial failure and collapse of numerous organizations is that good governance, risk management, and internal controls are essential to corporate success and longevity. Because of its unique and objective perspective, in-depth organizational knowledge, and application of sound audit and consulting principles, a well functioning, fully resourced and independent internal audit activity is well positioned to provide valuable support and assurance to an organization and its oversight entities.

2.3 What is enterprise risk management (ERM) and what role does internal auditing play in it?

Enterprise risk management is a structured and coordinated entity wide governance approach to identify, quantify, respond to, and monitor the consequences of potential events. Implemented by management, ERM is evaluated by the internal auditors for effectiveness and efficiency.

The practice of managing risk, which is a key element of governance, traditionally has been within individual business units and/or parts of business units; and to a lesser extent across the organization. Enterprise risk management (ERM) takes a broader portfolio approach and deals with risks and opportunities affecting the creation or preservation of organizational value.

Enterprise risk management is defined as a process, effected by an entity’s board of directors, management, and other personnel; applied in a strategy setting and across the enterprise; designed to identify potential events that may affect the entity; and manage risk to be within its risk appetite to provide reasonable assurance regarding the achievement of entity objectives.

Everyone in the organization plays a role in ensuring successful enterprise-wide risk management but management bears the primary responsibility for identifying and managing risk and for implementing ERM in a structured, consistent, and coordinated approach. The board, or its equivalent, has an overall responsibility for monitoring the risks and for gaining assurance that they are managed at an acceptable level. Internal auditors, in both their assurance and consulting roles, contribute to the management of risk in a variety of ways. They play a key role in evaluating the effectiveness of -- and recommending improvements to -- ERM. IIA- and ISACA- Standards specify that the scope of internal auditing should encompass risk management and control systems.

The internal auditors' varied roles in and emphasis on ERM are dependent on the maturity of the ERM process in the organization. The safeguard that should be put in place before the internal auditors carry out their ERM-related roles is to ensure that the entire organization fully understands management's responsibility for risk management.

The internal auditors' core ERM role is to provide objective assurance to the board and senior management on the effectiveness of the ERM activities in helping ensure key business risks are managed appropriately and the system of internal control is operating effectively.
Internal auditing's key ERM-related roles and assurance activities include:

- Providing assurance on the design and effectiveness of risk management processes.
- Providing assurance that risks are correctly evaluated.
- Evaluating risk management processes.
- Evaluating the reporting on the status of key risks and controls.
- Reviewing the management of key risks, including the effectiveness of the controls and other responses to them.

Additional legitimate internal audit roles and consulting activities may help to protect the internal auditors independence and objectivity when accompanied by adequate safeguards. They include:

- Championing the establishment of ERM within the organization.
- Developing risk management strategy for board approval.
- Facilitating the identification and evaluation of risks.
- Coaching management on responding to risks.
- Coordinating ERM activities.
- Consolidating the reporting on risks.
- Maintaining and developing the ERM framework.

The roles the internal auditors should NOT undertake are:

- Setting the risk appetite.
- Imposing risk management processes.
- Providing assurance to the board and management.
- Making decisions on risk responses. This is management's responsibility.
- Implementing risk responses on management's behalf.
- Accountability for risk management.

2.4 How do internal and external auditors differ and how should they relate?

Although they are independent of the activities they audit, internal auditors are integral to the organization and provide ongoing monitoring and assessment of all activities. On the contrary, external auditors are independent of the organization, and provide an annual opinion on the financial statements. The work of the internal and external auditors should be coordinated for optimal effectiveness and efficiency.

Internal and external auditors have mutual interests regarding the effectiveness of internal financial controls. Both professions adhere to codes of ethics and professional standards set by their respective professional associations. There are, however, major differences with regard to their relationships to the organization, and to their scope of work and objectives.
The internal auditors' are part of the organization. Their objectives are determined by professional standards, the board, and management. Their primary clients are management and the board. External auditors are not part of the organization, but are engaged by it. Their objectives are set primarily by statute and their primary client — the board of directors.

The internal auditors scope of work is comprehensive. It serves the organization by helping it accomplish its objectives, and improving operations, risk management, internal controls, and governance processes. Concerned with all aspects of the organization — both financial and non-financial — the internal auditors focus on future events as a result of their continuous review and evaluation of controls and processes. They also are concerned with the prevention of fraud in any form.

The primary mission of the external auditors is to provide an independent opinion on the organization's financial statements, annually. Their approach is historical in nature, as they assess whether the statements conform with generally accepted accounting principles, whether they fairly present the financial position of the organization, whether the results of operations for a given period of time are accurately represented, and whether the financial statements have been materially affected.

The internal and external auditors should meet periodically to discuss common interests; benefit from their complementary skills, areas of expertise, and perspectives; gain understanding of each other's scope of work and methods; discuss audit coverage and scheduling to minimize redundancies; provide access to reports, programs and working papers; and jointly assess areas of risk. In fulfilling its oversight responsibilities for assurance, the board should require coordination of internal and external audit work to increase economy, efficiency, and effectiveness of the overall audit process.
3. Professional proficiency in internal auditing

3.1 How does internal auditing maintain independence and objectivity?

INDEPENDENCE: The audit charter should establish independence of the internal audit activity by the dual reporting relationship to management and the organization's most senior oversight group. Specifically, the CAE should report to executive management for assistance in establishing direction, support, and administrative interface; and typically to the audit committee for strategic direction, reinforcement, and accountability. The internal auditors should have access to records and personnel as necessary, and be allowed to employ appropriate probing techniques without impediment.

OBJECTIVITY: To maintain objectivity, internal auditors should have no personal or professional involvement with or allegiance to the area being audited; and should maintain an un-biased and impartial mindset in regard to all engagements.

Independence and objectivity are two critical components of an effective internal audit activity. Independence & Objectivity:

"The internal auditor occupies a unique position he or she is employed by the management but is also expected to review the conduct of management which can create significant tension since the internal auditor's independence from management is necessary for the auditor to objectively assess the management's action, but the internal auditor's dependence on the management for employment is very clear."

Therefore, the internal audit activity should have a mandate through a written audit charter that establishes its purpose, authority, and responsibility to support its independence and objectivity within an organization.

Internal auditors are independent when they render impartial and unbiased judgment in the conduct of their engagement. To ensure this independence, best practices suggest the CAE should report directly to the audit committee or its equivalent. For day to day administrative purposes, the CAE should report to the most senior executive (i.e., the chief executive officer [CEO]) of the organization. The CAE should have direct communication with the audit committee which reinforces the organizational status of internal auditing, enables full support and unrestricted access to organizational resources, and ensures that there is no impairment to independence. This provides sufficient authority to ensure broad audit coverage, adequate consideration of engagement communications, and appropriate action on recommendations.

Independence is further enhanced if the CAE reports to the board through its audit committee on the planning, execution, and results of audit activities. The audit committee is also responsible for the appointment, removal, and fixation of compensation of the CAE. The committee should safeguard the independence by approving the internal audit charter and mandate periodically.
Objectivity is a mental attitude which internal auditors should maintain while performing engagements. The internal auditor should have an impartial, un-biased attitude and avoid conflict of interest situations, as that would prejudice his/her ability to perform the duties objectively. The results of internal audit work should be reviewed before they are released in order to provide a reasonable assurance that the work has been performed objectively.

Internal auditors should not assume any operational responsibility. Objectivity can be presumed to be impaired when internal auditors perform an assurance review of any activity for which they had any authority or responsibility within the past year or a period significant enough to influence their judgment or opinion. Internal auditors should not accept gifts or favors from others such as employees, clients or business associates.

The internal auditors should adopt a policy that endorses their commitment to abiding by the Code of Ethics, avoiding conflicts of interest, disclosing any activity that could result in a possible conflict of interests. Staff assignment of internal auditors should be rotated periodically whenever it is practicable.

3.2 What are the skill sets and staffing needs of internal audit activities?

A broad range of skills and expertise, and ongoing professional development are critical to the formation and maintenance of an effective internal audit activity. Essential elements include in-depth knowledge of the organization's industry and internal audit standards and best practices; technical understanding and expertise; knowledge on, skills for implementing and improving processes in both financial and operational areas; strong communication and presentation skills, and professional certification, e.g. CIA and CISA. Although some co-sourcing and outsourcing might be necessary when unique competencies and specialty skills are not affordable or available, the oversight and responsibility for the internal audit activity cannot be outsourced.

Today's internal auditors must provide to their audit committees explicit assurance on organizational governance, as well as meet ever-increasing demands of management and other stakeholders. They must excel as internal control and risk management experts to ensure the controls over key systems and business processes are robust and effective. To meet these high expectations, a solid staffing strategy is essential. It is the responsibility of the Chief Audit Executive (CAE) to establish an effective program for selecting and developing the internal audit team.

The skill mix, depth, and size of the audit team should be determined by the services expected by the audit committee and management in order to meet organizational needs. The resulting audit plan should be based on an assessment and ranking of risks, critical systems, and processes across the organization, and should consider the organization's long-term business objectives, expansion plans, and growth strategies; as well as short-term changes in the control environment such as M&A activities, major system implementations, and reengineering of business processes.
The maturity of the control environment, level of management accountability, and extent to which the organization depends on internal auditing to drive improvements will affect the resourcing outcome. Benchmarking against comparable organizations can provide useful insights into appropriate staffing.

When staffing an internal audit activity, management’s options include:

- **Establishing a dedicated audit team** with requisite resources.
- **Cosourcing**, by which an external provider supports the CAE and the dedicated audit team with supplementary specialist skills that might be too costly to maintain in-house. This option affords flexibility that enables the team to upsize or downsize according to the needs of the business.
- **Maintaining a dedicated audit team supported by rotations** that provide the opportunity for business-unit personnel to gain valuable, broad-based knowledge of the business as well as education on issues regarding internal control and risk management. In some Fortune 1000 companies, an internal audit assignment is a pre-requisite for senior financial or general management positions.
- **Outsourcing the internal audit activity to an external provider.** This option may be cost-effective for smaller organizations, geographically dispersed entities, or organizations with specific technical expertise. **NOTE: The Institute of Internal Auditors (IIA) believes the internal audit activity should never be fully outsourced, but should be managed from within the organization, preferably by a competent CAE.**

The staffing option taken should result in an internal audit team that possesses the skills necessary to meet the group’s objectives. Ideally, the audit activity should comprise individuals with diverse backgrounds, skill sets, and experience to provide adequate control assurance to support the business on a broad range of risk and internal control matters. Increasingly internal audit activities are performed by multi-disciplinary teams that include engineers, accountants, management graduates, and even environmental specialists who reflect a broad range of today’s assurance needs. Also, information technology audit experts are a core component of modern-day internal audit activities. It very well might not be possible to accommodate all the requisite technical skills in-house. Therefore, the CAE should be empowered to obtain assistance and support from experts outside the organization as needed. Control self assessment, facilitation, and risk and internal-control training are increasingly falling under the purview of internal auditors. As such, to be their most effective, they must demonstrate:

- Strong interpersonal skills.
- Effective oral and written communications skills.
- Good coaching and group leadership skills.
- The ability to influence at all levels.
An annual review of the staffing strategy by the CAE should be based on defined parameters such as the audit committee's assurance needs, management's expectations, business growth and strategies, dispersion of operations, achievement of audit objectives, compliance to regulations, and staff turnover. The CAE should assess the skills and requirements of team members and promote continuing professional development to maintain professional designations and enhance knowledge, skills, and competencies in all relevant areas.

Not having adequate and competent staff in the internal audit activity is a risk that exposes the organization to inadequate evaluation of the effectiveness of risk management, control, and governance processes.

Finally, The Institute of Internal Auditors (IIA) with the Certified Internal Auditor® (CIA) and the Information Systems Audit and Control Association (ISACA) with the Certified Information Systems Auditor® (CISA) offer globally accepted certifications for internal auditors and remains the standard by which individuals demonstrate their competence and professionalism in the internal audit field.

3.3 How does the internal audit activity go about prioritizing its resources?

Effective prioritization involves staying in sync with the organization's risk priorities and taking a risk-based approach to internal audit planning. By continuously monitoring organizational changes that might alter the plan, the CAE should be well equipped and positioned to make informed and educated recommendations to management and the board on the most effective use of internal audit resources.

Given the potential size of the audit universe, the related scope of work, and the need for efficient use of limited internal audit resources, it is critical to prioritize and plan audit engagements, based on an annual risk assessment that is viewed from the perspective of organizational goals and objectives.

Most models used by CAEs for prioritization of their audit work, take into consideration such factors as financial impact, asset liquidity, management competence, quality of internal controls, degree of change or stability, time of last audit engagement, complexity, and strategic risks. In conducting audit engagements, methods and techniques for testing and validating exposures should consider the risk materiality and likelihood of occurrence.

Although the annual audit plan's subject areas will vary as a result of the internal audit activity's risk assessment and related drivers, it should always address two critical areas:

1. Throughout the year, the CAE should perform a sufficient amount of audit work and gather enough information to form an educated judgment about the adequacy and effectiveness of the organization's risk management and control processes.
2. The internal audit activity should review the organization's regulatory compliance programs.
Once a risk-based audit plan is developed, the CAE should communicate the internal audit activity's plans, resource requirements, and related limitations to senior management and to the appropriate governing body for review and approval. Changes in management direction, objectives, emphasis, and focus should be reflected by changes to the audit universe and related audit plan, which might require frequent (quarterly) updating. All significant changes should be submitted to the oversight entities for review and approval. Ultimately, the audit plan should address and support how the most effective use of internal audit resources. Aligning internal audit activities with the organization's operational and strategic goals and objectives through a risk assessment will ensure efficient utilization of internal audit resources while providing management with valuable insights on risk management activities.

3.4 What standards guide the work of internal audit professionals?

As part of The Institute of Internal Auditors' (IIA) „Professional Practices Framework“, the „International Standards for the Professional Practice of Internal Auditing (Standards)“ outline the tenets of the internal audit profession. And more IT-focused the „IS Standards, Guidelines and Procedures for Auditing and Control Professionals“ from the Information Systems Audit and Control Association (ISACA) provide comprehensive guidance for the profession Other applicable guidance, pronouncements, and regulations also may have an impact on how internal auditing is performed; and may provide clarification and delineation of acceptable and recommended processes.

Although the practice of internal auditing is not regulated, The Institute of Internal Auditors (IIA) and the Information Systems Audit and Control Association (ISACA) provide comprehensive guidance for the profession. The Institute of Internal Auditors (IIA) published its „Framework for Standards for the Professional Practice of Internal Auditing“ (PPF) which comprises the official definition of internal auditing, the „International Standards for the Professional Practice of Internal Auditing“, the „Code of Ethics“, „Practice Advisories“, and development and practice aids (http://www.theiia.org/?doc_id=1499). The Institute of Internal Auditors (IIA) also provides guidance on assessing, maintaining, and improving quality within the internal audit activity. Focused on IT the Information Systems Audit and Control Association (ISACA) published the “IS Standards, Guidelines and Procedures for Auditing and Control Professionals” which includes the “IS Auditing Standards“ , “IS Auditing Guidelines“ and “IS Auditing Procedures“ (http://www.isaca.org/AMTemplate.cfm?Section=Standards2&Template=/ContentManagement/ContentDisplay.cfm&ContentID=27785). These high level standards cover the whole framework of audit work. You find global aspects as audit charta, code of ethics, standards and best practices as well as general statements to audit processes like risk assessment, planning, field-work, reporting, documentation, follow-up audit, audit resource management and consulting e. g.
Several professional organizations offer certification programs. For example, the “Certified Internal Auditor®” (CIA) by The Institute of Internal Auditors (IIA) and the “Certified Information Systems Auditor®” by the Information Systems Audit and Control Association (ISACA) are globally accepted certifications for internal auditors and remains the standard by which individuals demonstrate their competence and professionalism in the internal audit field.


3.5 How to develop and maintain quality assurance and improvement?

The chief audit executive (CAE) should develop and maintain a quality assurance and improvement program that covers all aspects of the internal audit activity and continuously monitors its effectiveness. This program includes periodic internal and external quality assessments and ongoing internal monitoring. Each part of the program should be designed to help the internal auditing activity add value and improve the organization’s operations and to provide assurance that the internal audit activity is in conformity with the Internal Audit Standards and the Code of Ethics.

The CAE should consider establishing a quality assurance process (e.g., interviews, customer satisfaction surveys, assignment performance surveys, etc.) to understand the auditees’ needs and expectations relevant to the IS audit function. These needs should be evaluated against the charter with a view to improving the service or changing the service delivery or audit charter, as necessary. When adopting the quality assurance process the CAE should implement a process to monitor and assess the overall effectiveness of the quality program (for example see „Standard 1300 – Quality Assurance and Improvement Program“ from The Institute of Internal Auditors’ (IIA) „Standards for the Professional Practice of Internal Auditing“, http://www.theiia.org/?doc_id=1499). The process should include both internal and external assessments. Internal assessments should include:

- Ongoing reviews of the performance of the internal audit activity; and
- Periodic reviews performed through self-assessment or by other persons within the organization, with knowledge of internal audit practices and the Standards.
External assessments should be conducted at least once every five years by a qualified, independent reviewer or review team from outside the organization. The potential need for more frequent external assessments as well as the qualifications and independence of the external reviewer or review team, including any potential conflict of interest, should be discussed by the CAE with the Board. Such discussions should also consider the size, complexity and industry of the organization in relation to the experience of the reviewer or review team. The CAE should communicate the results of external assessments to the board.

Internal auditors are encouraged to report that their activities are "conducted in accordance with the standards for internal auditing. However, internal auditors may use the statement only if assessments of the quality improvement program demonstrate that the internal audit activity is in compliance with the standards. Although the internal audit activity should achieve full compliance with the standards and internal auditors with the Code of Ethics, there may be instances in which full compliance is not achieved. When noncompliance impacts the overall scope or operation of the internal audit activity, disclosure should be made to senior management and the board."