

A Standardized Approach for Peer Review of Internal Audit

The quality of enterprise governance and the questionable judgment and roles of internal auditors have resulted in some financial reporting irregularities, fraud and various forms of malpractice such as insider trading. As a result, organizations have faced financial, legal and reputational losses. This has been made evident by a spate of incidents such as the 2015 Toshiba accounting scandal,¹ the 2009 Satyam financial misstatement scam,² and the 2001 Enron accounting and corporate fraud crimes.³ To counter this, it is essential to have a peer reviewer consistently monitor the quality and efficiency of the internal audit department to identify and help avoid any potential malpractice or errors that might be a result of inefficient or poorly conducted internal audits. To ensure the independence and sanctity of the peer review process, it is recommended to make the peer review process an external function by using a third party that is qualified to provide an assessment of internal audit best practices. By understanding best practices of the peer review process and the parameters for selecting an appropriate external third party to perform it, organizations can improve the quality of audit and assurance services. A peer review tool can be an effective way to identify reviewers through quantitative scoring and measure the effectiveness of the peer review process.

Peer Review Process Key Objectives

To promote and enhance quality in auditing practices, an organization's senior leadership must understand the essence of the peer review process. A peer review of an organization's internal audit department should have several key objectives, as shown in **figure 1**.



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FIGURE 1

Peer Review Key Objectives

Objectives	Peer Review Objective Statement
Objective 1	Ensure that governance of internal audit is independent and can fulfill its mandate as determined by the audit committee.
Objective 2	Ensure that internal audit is carrying out the function of the third line of defense appropriately and with efficiency.
Objective 3	Verify that key material weakness is assessed appropriately and correct risk ratings are apportioned to it.
Objective 4	Ensure that all such material weaknesses and key findings with the appropriate risk statements are presented to management.
Objective 5	Ensure that a risk assessment mechanism is in place, and the internal audit department has used it to derive the key focus of audit domains.
Objective 6	Verify that an issue management process is in place and key critical and highly rated issues are actioned in a timely manner.
Objective 7	Ensure that internal auditors have applied auditing standards and professional judgement with due professional care.
Objective 8	Ensure that the quality of an internal auditor's work is challenged and the methodology of each audit procedure that they carry out or fail to carry out comes under independent scrutiny.
Objective 9	Identify internal audit irregularity that does not conform to the normal laws, practices and rules of the audit profession, having the deliberate intent to deceive or defraud.
Objective 10	Detect the possibility of dissemination of irrelevant findings, unwarranted claims, unacceptable interpretations and personal biases in the audit process.
Objective 11	Assess the professional competence of the auditors and deduce that they are qualified to carry out a given audit.
Objective 12	Ensure proper checks and balances are in place so that no deviation exists per the audit life cycle defined by the internal audit department.

Peer Review Process Key Criteria

Any independent audit organization planning to perform peer reviews for an internal audit department must adhere to key criteria (**figure 2**). These key criteria are imperative to ensure objectivity and efficacy in the review process. The criteria can be separated into three categories:

- 1. Strategic**—These criteria enable enterprises to align with organizational and departmental strategy and direction. These should support the organization in pursuing its overall strategy.
- 2. Operational**—These criteria help to utilize the operational capacity of people, processes and technology and link them to enterprise strategic goals and objectives.
- 3. Tactical**—These criteria support the steps taken to achieve the strategic objective.

Parameters for Selecting a Third Party for Peer Review

To choose a competent and objective assessor, key selection criteria should be identified based on

industry experience and knowledge obtained as part of the third line of defense (**figure 3**).

Using a Scoring Tool

A tool that should be used to select a third party and quantify the success of the third-party assessment program has been developed.

Any organization can use such a tool as a starting point and customize it per their requirements. It is essentially to use a scoring sheet to objectively compute the efficiency of the peer review process and gauge the parameters of the peer reviewer selection process.

Organizations complete one scoring process for peer reviewers (**figure 4**) and one for the third-party reviewer assessment (**figure 5**). In the scoring sheet, each criterion is rated as high, moderate or low and given a weighting of critical, high or medium, and that weighting is given a numeric score (i.e., crucial, 10; high, 5; medium, 2). Once the criterion is rated, the sheet computes a score based on the weight of the criterion/parameter (as the case may be) and the selected choice.



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FIGURE 2**Peer Review Key Criteria**

	Peer Review Process Criteria	Description	Category
1.	Independence	The peer reviewer must not have any financial interest in the organization being reviewed.	Strategic
2.	Established accountability	The peer reviewer must be held completely accountable for the review process, monitoring and outcomes.	
3.	Integrity	The peer reviewer must ensure that the review has been performed with the utmost professional integrity and should exhibit conviction to all stakeholders.	
4.	Trust	The peer reviewer should not misuse the information garnered during the review to benefit themselves or any other third party. It should be ensured that the peer reviewer does not leak the reviewed organization's data to a competitor or indulge in insider trading.	
5.	Scope	The scope of the peer reviewer should be jointly decided by the peer reviewer and the reviewed organization. However, the reviewed organization can decide the extent or depth of the review to be conducted. Such authority is not limited by any considerations other than ensuring that the objectives of the review are achieved.	
6.	Defined governance	The governing authority of the review process must be defined to monitor and guide the overall process, ensuring that it meets the review objectives.	
7.	Focus on context	The peer reviewer must perform a review that aligns with the organization's needs and scope and is not limited to a rigid procedure or checklist.	
8.	Communication	The method of communication and reporting of the outcome of the review should be predefined and should ensure that all relevant stakeholders receive regular updates along with the results of the review.	Operational
9.	Defined periodicity (once every three years)	The peer reviewer must perform the review on a periodic basis as per the defined frequency or the organization's business needs (recommended at least once every three years).	
10.	Defined outcomes (quality and effectiveness)	The peer reviewer must document and report the outcome (quality and effectiveness) of the peer review process to the governing authority and the reviewed organization.	
11.	Focus on key elements	The peer review process should focus on key aspects such as: <ul style="list-style-type: none"> • Adherence to a defined audit process by the internal audit department • Corroboration of the audit charter and the risk environment defined by the internal audit department • Validation of the internal audit department's governance structure to ensure independence • Key risk and rationale identified • Integrity of internal auditors • Overall internal audit department efficiency and productivity 	Tactical
12.	Competence	The peer reviewer must be equipped with the appropriate abilities, knowledge and skills to perform the review in an efficient manner.	
13.	Additional coverage	In case the review process will be applied to another audit of a system at a later date, transaction, process or any other supporting department of the organization to fulfill the mandate and achieve the objectives of peer review, the third party should have adequate resources and skill sets to support an additional review.	
14.	Data privacy and data security considerations	The peer reviewer must comply with the data security norms of the reviewed organization and should have a signed nondisclosure agreement (NDA) in place to protect confidential data and personally identifiable information (PII) from being mishandled or exposed to unintended audiences.	

FIGURE 3

Third Party Selection Criteria

	Third Party Selection Criteria	Description	Category
1.	Qualifications and licensing	To perform a peer review of an organization, the peer reviewer must be provisioned with appropriate licensing and registration with the competent authority that is mandatory per the applicable laws and regulation of the given country.	Strategic
2.	Industry experience	The peer reviewer must have experience performing reviews and audits of an internal audit department of an external organization (e.g., to audit an insurance section, the selected auditor must have reasonable experience with insurance firms).	
3.	Reputation of the audit organization	The peer reviewer must hold credibility to perform the audit assignments and have a good reputation in the market for the same. The reviewer must undergo a background check as per the applicable laws and regulation of the given country to ensure its credibility.	
4.	Use of technology	The peer reviewer must be equipped with the relevant tools and technology necessary to perform the review.	Operational
5.	Quality assurance processes in place	The peer reviewer must have a proper quality check process in place to monitor the review process and report correct outcomes.	
6.	Financial efficiency	The peer reviewer should meet the organization's budget criteria for performing the review process.	Financial
7.	End-to-end support	The peer reviewer must provide appropriate guidance on best practices of the internal audit department to help efficiency and risk management.	Tactical
8.	Timeliness	The peer reviewer must be able to perform the review within the organization's specified timeline.	

FIGURE 4

Peer Review Scoring Process Example

Peer Review Process Criterion	Select Any One Choice	Weight	Weight Score (Critical-10, High-5, Medium-2)	Score	Final Score	Grading
Independence	Independence Assured	Critical	10	50	80	Least Efficient
Competence	Moderately Capable	Critical	10	30		
Scope Definition		Critical	10	0		

FIGURE 5

Peer Review Scoring Process Example

Peer Reviewer Selection Parameter	Select Any One Choice	Weight	Weight Score (Critical-10, High-5, Medium-2)	Score	Final Score	Grading
Qualifications/ Licensing	Moderately Qualified and Moderate Licensing	Critical	10	30	30	Third party did not pass the assessment
Industry Experience		Critical	10	0		

The weight provided in the scoring sheet is recommended. However, based on the organization's business requirement, appropriate adjustments can be made.

Guard rails for grading the final score are shown in **figures 6** and **7**.

FIGURE 6
Scoring for the Peer Review Process

Score	Result
700>Calculated Score>400	Highly Efficient Review
400>Calculated Score>200	Moderately Efficient Review
200>Calculated Score	Low Efficient Review

FIGURE 7
Scoring for Third-Party Reviewer Assessment

Score	Result
Calculated Score>150	Third party passed the assessment
Calculated Score<150	Third party did not pass the assessment

Conclusion

Establishing peer review parameters provides organizations with a measurement tool to ensure an efficient peer review process and gauge the peer reviewer selection process. A peer review process that includes the assessment of internal audit is essential to ensure that it is carrying out the function of third line of defense appropriately and with efficiency in the auditable entities and to protect the organization from financial and reputational repercussions.

Endnotes

- 1 Farrell, S.; "Toshiba Boss Quits Over £780m Accounting Scandal," *The Guardian*, 21 July 2015, www.theguardian.com/world/2015/jul/21/toshiba-boss-quits-hisao-tanaka-accounting-scandal
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- 3 Tran, M.; "How Enron Lost its Spark," *The Guardian*, 29 November 2011, <https://www.theguardian.com/business/2001/nov/29/corporatefraud.enron1>