

CHAPTER 15 THE CONSULTING ENGAGEMENT Illustrative Solutions



Review Questions

1. There are several fundamental differences between assurance services and consulting services: the number of parties involved in the engagement, the application of *The Institute of Internal Auditors' (IIA's) International Standards for the Professional Practice of Internal Auditing (Standards)* to both types of services, the purpose of the engagement, and communication of the results of the engagement.
2. The three types of consulting engagements performed by the internal audit function are:
 - Advisory (for example, advising on control design).
 - Training (for example, training on risk management and internal control).
 - Facilitative (for example, facilitating management's control self-assessment).
3. Blended engagements incorporate elements of both consulting and assurance services into one consolidated approach. Blended engagements are indicated when it is cost-effective or otherwise desirable to combine a component of assurance, such as the independent assessment of a process or controls, as well as a component of consulting, such as advising or facilitation.
4. The three ways that potential consulting engagements are identified are:
 - Engagements are proposed during the annual risk assessment process and, if identified as high-priority, included in the annual internal audit plan.
 - Specific engagements are requested by management.
 - New or changing conditions warrant internal audit attention.
5. When selecting consulting engagements to perform, the internal audit function uses a risk assessment process similar to management's assessment and prioritization process. Unlike management's risk assessment, the internal audit function typically evaluates risks based on many more factors than just impact and likelihood. Frequently, those factors are individually weighted and finely defined according to a scale. Additionally, some internal audit functions add a subjective priority rating that is applied to each potential consulting engagement according to the importance the internal audit function places on it. The internal audit function also considers the amount of resources required and the skills necessary to perform the consulting engagement, as well as the audit customer's needs and expectations.
6. The internal audit plan is created on an annual basis and includes those areas within the organization that have gone through the risk assessment process and were selected as priorities for the internal audit function. For many internal audit functions, these priorities represent both assurance and consulting engagements. Although, assurance engagements typically make up the bulk of the internal audit plan, some consulting engagements, such as systems development, known due diligence, and large change initiatives, can be known when the internal audit plan is being created and should be included. Additionally, hours should be reserved in the internal audit plan for consulting engagements that may be introduced during the year. Although consulting engagements are often identified after the internal audit plan has been created, they usually are still subjected to the internal audit function's risk assessment process before a decision to add it to the audit plan is made.
7. Generally, the phases of an advisory consulting engagement are similar to those of an assurance engagement. They are (1) planning, (2) performing, and (3) communicating.

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8. Working papers are important for consulting engagements to create a record of the work performed to support the advice provided to the customer. Specifically, this documentation should corroborate the assumptions and hypotheses underlying the advice. Additionally, this documentation will enhance the effectiveness and efficiency of future consulting engagements.
9. Chief audit executives (CAEs) can educate management regarding the value of consulting engagements by showing them how the unique skills and knowledge of the internal audit function can add value through advisory, training, and facilitation activities while partnering with other areas of the organization.
10. Consulting engagements require the internal auditor to have the ability to deal with ambiguity and find solutions without much guidance. Typically, consulting engagements are time sensitive and the internal auditor must meet established deadlines to have a positive impact on the decision process. Also, communication and relationship skills are critical to the success of consulting engagements. Typically, internal auditors who have the most experience and familiarity with an area can provide the most value on consulting engagements for that area. Other skills required of internal auditors who perform consulting engagements include versatility, the ability to learn new things quickly, experience and expertise in process design and engineering, facilitation skills, strategic thinking, consensus building, and creative problem-solving abilities.
11. Outside specialists that may be asked to assist with a consulting engagement include:
 - Internal audit service providers.
 - Independent outside accountants or tax specialists.
 - Information technology and security specialists.
 - Fraud investigators.
 - Actuaries, statisticians, and appraisers.
 - Engineers, geologists, and environmental specialists.
 - Lawyers.

Multiple-choice Questions

1. **C** is the best answer. Reviewing policies and procedures is a typical consulting activity. The other choices relate to testing of controls and are assurance activities.
2. **D** is the best answer. Financial statement attestation work is not performed by the internal audit function. It is performed by the independent outside auditor and, therefore, is not a requirement of the internal audit function's consulting engagements. Availability of adequate internal audit resources (both in terms of experience in the area for which consulting is performed and sufficient time availability to complete the consulting engagement) is a consideration when performing consulting engagements. Consulting engagements are motivated by either client demands or events going on in the corporation to which the CAE may want to dedicate resources. Consequently, the specific motivations prompting the engagement should be considered. Additionally, overall audit resources must be considered when determining how a particular consulting engagement fits in with other priorities.
3. **B** is the best answer. A training consulting engagement will best provide the education requested by senior management. A facilitative consulting engagement is not indicated because it requires the internal audit function to have a more ongoing role. An advisory consulting engagement would not



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provide the education that senior management has requested. An assurance engagement would not be appropriate in these circumstances.

- C** is the best answer. To appropriately provide consulting services, the internal audit function should be part of the review process and should not develop or install processes, procedures, or systems. The internal audit function should not be responsible for designing controls, develop policies, or lead a project.
- D** is the best answer. Consulting engagements are not performed for the purpose of assessing the design adequacy or operating effectiveness of a process, therefore, no conclusion would be expressed. Understanding the objectives of a process, assessing the risks in a process, and flowcharting the key steps in a process all may be steps in a consulting engagement.
- B** is the best answer. Determining the bonus formula is a management responsibility and should not be performed by the internal audit function. Researching and benchmarking incentive plans, recommending monitoring procedures, and determining documentation to support incentives paid are appropriate activities for the internal audit function to perform in a consulting engagement.
- B** is the best answer. Because this is a consulting engagement and not an assurance engagement, the CAE should discuss the problem with the customer and determine together whether the engagement should continue. It would only be appropriate to complete the analysis without the data, but include the scope limitation in the engagement report, if it were an assurance engagement. Halting the engagement to conduct a separate one or reporting the scope limitation to the independent outside auditors would rarely be appropriate.
- C** is the best answer. The internal audit function can best assist with the annual risk assessment process with a facilitative consulting engagement. An assurance engagement would not be appropriate as the internal audit function is not being asked to assess the design adequacy or operating effectiveness of internal controls. A training consulting engagement is not indicated because the audit committee has not requested any educational services, and an advisory consulting engagement is not appropriate because no advice was requested.

Discussion Questions

- One of the primary ways to ensure independence and objectivity is to assign resources in such a way that the internal auditors who perform the consulting engagement do not get assigned to perform the assurance engagement in which that area is evaluated. Another option is to use outside resources (consultants/third-party service providers) who are specialists in the area requesting consulting services for the consulting engagement so that corresponding assurance engagements can be performed by personnel within the internal audit function. Keep in mind that management is ultimately responsible for implementing and monitoring adherence to internal controls, so it is reasonable for the internal audit function to maintain independence by asking management to confirm that responsibility in writing on individual engagements.
- During the course of conducting an advisory consulting engagement the internal auditor identifies a control weakness, the first course of action is to discuss the facts with the engagement customer. If the internal auditor determines that the control weakness is significant and the customer resists taking remedial action, the internal auditor is obligated to disclose the control weakness to senior management and the audit committee. Such a disclosure could create conflict between the internal



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auditor and the customer, and may dissuade the customer from requesting future consulting engagements. However, for the internal auditor to fulfill his or her responsibilities, the disclosure must be made so that achievement of organizational objectives is not threatened.

- Objectivity can be compromised any time the internal audit function performs management functions and/or makes management decisions. In instances when the internal audit function is asked to lend staff to management to perform positions on an interim basis, the potential damage to the internal audit function's independence and the individual internal auditor's objectivity can be minimized by ensuring that the borrowed staff clearly report to management during this period of time. In addition, the internal auditors who perform management roles should be precluded from performing assurance engagements in which the applicable area is being evaluated for a period of not less than one year. Typically, internal audit functions err on the side of conservatism by declining consulting engagements that may have the appearance of compromising independence.
- In some instances, management or the audit committee may be somewhat averse to the concept that internal auditors should provide consulting services, primarily because they fear it would impair the internal auditors' objectivity. Therefore, some internal audit functions may choose to omit specific references to consulting services in their charter. However, the authors believe it is important that the internal audit charter include provisions for consulting engagements. Doing so outlines the need for the internal audit function to have access to all areas of the organization when performing consulting engagements as it does when performing assurance engagements. Not including consulting services in the charter can create confusion should the internal audit function decide to provide any form of advice, and may increase the likelihood for disagreement regarding the internal audit function's position on consulting services.
- The internal audit function must assess the risks to itself as well as to the organization when determining whether to accept a consulting engagement. Consulting engagements can create an environment in which the internal audit function can compromise independence and internal auditors can compromise objectivity if the risks are not identified and assessed. Impairment to either independence or objectivity can adversely affect the organization as a whole as the impairment can compromise the reliance senior management and the audit committee place on the internal audit function's independent assessment of the system of internal controls when assurance engagements are performed.
- When assurance and consulting services are combined in a single engagement, it is referred to as a blended engagement. Blended engagements are indicated when it is cost-effective or otherwise desirable to combine a component of assurance, such as the independent assessment of a process or controls, as well as a component of consulting, such as advising or facilitation.
- The internal audit function can participate in an acquisition in different ways, depending on the needs of senior management. When the internal audit function is asked to assess the process through which senior management evaluates potential acquisitions and opines on whether the relevant internal controls related to the process are designed adequately and operating effectively, it is providing assurance services. When, on the other hand, senior management asks the internal audit function to assess the potential acquisition and advise whether it is suitable, the internal audit function is providing an advisory (consulting) service. The internal audit function may be asked to provide one or both types of services for a given acquisition.
- When facilitating an enterprise risk assessment, the internal audit function should gather information from individual management executives relative to the risks that their respective areas are likely to



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face based on what is currently known. The collected information should then be distributed to, and discussed with, senior management, optimally in a meeting facilitated by the internal audit function during which senior management can discuss and collectively come to agreement on the highest risks facing the organization. When those risks have been identified, the internal audit function continues to facilitate the process by encouraging the management executives to take ownership for the risks their area can impact. The internal audit function can then facilitate follow-up by encouraging senior management to meet periodically through the year to report on the status of the risks.

Cases

Case 1 - Privacy

The IIA has numerous current sources on privacy practices and should be the starting point for an update on privacy risks and control activities. One recent report from The IIA Research Foundation is "Privacy - Assessing the Risk" published in April 2003. A more recent guide provided from The IIA is part of the Global Technology Audit Guide Series (GTAG) - Guide 5 - *Managing and Auditing Privacy Risks* and is available for download free from The IIA's website (www.theiia.org) or a hard copy can be purchased through The IIA. Searching for "privacy" on the website will provide a number of links to specific current information.

In addition, the websites of eBay and other companies with similar business models should be searched for privacy statements and other relevant information. If time allows, the CAE and/or other members of the internal audit management team should network with the internal audit functions of those organizations to discuss trends and issues related to privacy.

The consulting engagement steps would include the following:

- Obtain privacy best practices information from the sources listed above.
- Obtain an understanding of the company's existing privacy policies and procedures.
- Compare the company's policies and procedures with best practices and identify gaps.
- Draft a privacy policy statement that reflects industry best practices.
- Meet with the CEO to discuss the proposed privacy policy statement.

Other areas of the company that should be asked to participate in the project include, for example, information technology, marketing, legal counsel, and any other areas involved in the communication or enforcement of the privacy policy.

The documentation prepared by the internal audit function should reflect the steps in the consulting engagement listed above. In particular, a matrix should be prepared comparing the company's current privacy practices to best practices so that gaps can be documented. The most important document is the best practices privacy policy requested by the CEO. Additional documentation might include, for example, a proposed implementation plan that addresses the gaps between the company's current policies and procedures and best practices, an estimated timeline for completing the implementation plan, and suggested training.

The internal audit function should discuss the consulting engagement outcomes identified above with the CEO. The discussion should focus on the best practices privacy statement drafted by the



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internal auditors and the commitment of resources that will be required to implement the proposed policies and procedures.

Due professional care must be taken to ensure that the internal audit function can maintain independence and objectivity for future internal audit coverage of policy maintenance and operational compliance. Ultimate ownership and responsibility for the privacy policy, including its maintenance, will need to be assigned to a senior management representative outside the internal audit function. Likewise, there should be a formalized review and approval process of the proposed privacy policy by the board of directors as part of the implementation plan.

Case 2 - Outsourcing

The situation depicted in this case study is becoming common among organizations that outsource functions that may not be viewed as core to the operation. Internal auditors need to be familiar with these situations and adapt their consulting services as the transition takes place. The internal audit function should work closely with management within the organization to coordinate appropriate audit activities.

A. It is not a conflict of interest for an organization to take an equity position in a potential vendor, however, this situation should be viewed as an atypical due diligence engagement. In many situations it may be advantageous for the organization to make an investment in a vendor. If the investment is significant enough, it may result in the organization securing seats on the board of directors of the vendor organization and influencing the strategic direction. By emphasizing and evaluating the internal control structure of the organization with which they are forming the alliance, the internal audit function can provide support for management's decision to take such an equity position.

B. The internal audit function can play a key role to ensure that all the appropriate groups are involved in the transition. Additionally, the internal audit function should ensure that all areas that are significantly impacted by processes related to human resources are involved in the evaluation criteria and vendor selection. Special emphasis should be placed on areas such as: finance, information systems, procurement, information security, business continuity, compliance, and any other areas with a particular reliance on human resources processes and control.

The internal audit function can have significant impact by ensuring that all of the applicable areas are collaborating on the project. The internal audit function also should review the contract and the financial aspects of the transaction. In a transaction such as this, there would be a need to ensure anticipated cost savings and related operation efficiencies are achieved. Finally, the internal audit function can help monitor changes in controls and procedures to ensure the post-transition system of internal controls at the vendor remain at the level expected during the vendor selection process.

C. Customer service and employee confidentiality provided by the human resource function would be significant risks during the transition. As with any significant change in operating processes, especially when employees are affected, the more things that change the greater the risk of error, confusion, and dissatisfaction. Information security and regulatory compliance as related to transaction information would also be of concern, including the confidentiality of personnel information and timely filing of regulatory information (for



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example, taxes withheld). Another potentially significant risk relates to employee morale and focus during such a transition. Change management is a critical enabler in outsourcing engagements and the internal audit function will need to evaluate whether appropriate change management steps are being taken.

The risk rating would change after outsourcing based on a number of factors. The internal audit function should evaluate the new internal control structure (design) surrounding the new organization and human resources processes. Based on the results of that evaluation and the effectiveness of those processes, the risk ranking for these functions could either increase or decrease. The audit scope could change based on either improved control activities or a decrease in the design adequacy and operating effectiveness of control activities. Some areas to look at specifically would be information security, transaction processing and balancing, and regulatory reporting as well as confidentiality of information.

D. Consulting activities relative to the vendor should be coordinated through management or, if applicable, vendor management. Consulting engagements could include many of the same services that were performed prior to these functions being outsourced. The internal audit function should pay particular attention to management oversight and monitoring controls that should be in place to ensure the outsourced processes are operating in compliance with the service contract as well as meeting anticipated satisfactory customer service levels. The internal audit function should perform compliance testing to verify that the vendor is meeting the terms of the contract and that established management monitoring processes are operating effectively.