



MUTUAL **E**XPECTATIONS **P**APER

Internal Audit Function in European Agencies and Other Bodies

**What you can expect from the IAS
What the IAS expects from you**



5 March 2010

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1. INTRODUCTION

The Commission's Internal Auditor exercises the same power as he/she does in respect of Commission's departments over the bodies set up by the Communities and having legal personalities that receive contributions charged to the general budget of the European Union¹.

The Internal Auditor of a European Institution² advises the institution on dealing with risks by issuing:

- ✓ Independent opinions on the quality of management and control systems;
- ✓ Recommendations for improving the conditions of implementation of operations and promoting sound financial management.

As internal auditor of the Agencies, the IAS reports on its audit work to the Management Boards (thereafter "Board") – through its Audit Committee, when applicable - and the Executive Directors³ (thereafter "Director").

Assurance audit engagements conducted by the Internal Audit Service (IAS) have two main purposes. Firstly, they intend to

support the auditees by assessing the adequacy and effectiveness of their internal control, risk management and governance processes and identifying areas that may need additional Management attention. Secondly, they provide the information required to provide an independent assurance to the Board and the Director⁴. Certain principles for the conduct of assurance audit engagements derive from these two main purposes. This paper describes the relationship between auditor and auditee to clarify responsibilities and set expectations so that audits are smooth, efficient and effective.

This document refers to bodies for which the IAS acts as the internal audit function according to Art. 185 of the Financial Regulation and other bodies for which the IAS has taken over this function - this document refers to all of them as "Agency".

The IAS aims at providing internal audit services in compliance with the "International Standards for the Professional Practice of Internal Auditing (Standards)" issued by the Institute of Internal Auditors (IIA).

The procedures outlined in the following sections are only applicable to assurance audit engagements. (See Annex I for examples of the type of assurance audit engagements). The procedures can be simplified for other audit



The Internal Auditor shall be responsible in particular for assessing:

- ✓ The suitability and effectiveness of internal management systems and the performance of departments in implementing policies, programmes and actions by reference to the risks associated with them;
- ✓ The suitability and quality of the internal control and audit systems applicable to every budgetary implementation operation.

¹ Art. 185.1 of the Financial Regulation

² See Art. 86.1 of the Financial Regulation (EC, Euratom) n° 1605/2002

³ "Director" is also used to refer to the "Executive Director" or to the "Administrative Director"

⁴ See Art. 72.1 of the framework Financial Regulation (EC, Euratom 2343/2002) or other relevant document that sets out legal link between the Agency and the IAS.

engagements and adapted to suit other audit activities such as desk reviews, audit risk assessments and consulting engagements.

This paper is based on relevant professional standards and regulations⁵, acquired experience and best practices identified from various sources. This paper does not replace these source documents, but it is intended to be a guide providing detailed information on the different steps of the audit process and actors involved.

A code of rules sufficiently detailed to cover all situations and circumstances would not be practicable. Auditor and auditee will therefore have to cooperate on each audit engagement and the auditor will use his professional experience and judgement in determining the specific procedures required under particular circumstances. Exceptions should be discussed between the auditor and auditee, if possible at the beginning of an engagement, and appropriately documented.

2. RISK ASSESSMENT & ANNUAL AUDIT PLAN (STRATEGIC PLANNING)

The IAS work is based on a three-year plan, which is the basis for an annual plan of internal audit activities in each Agency. The strategic audit plan is based on a risk assessment carried out by the IAS and takes account of:

- ✓ The IAS prior risk assessments and audit work;

⁵ Sources include: relevant articles of the Financial Regulation and its implementing rules (EC,Euratom 1605/2002);

- The framework Financial Regulation (EC,Euratom 2343/2002)for the bodies referred to in Article 185 of Council Regulation;
- Standards, Code of Ethics and other mandatory and highly recommended guidance of the IIA (www.theiia.org);
- The IAS Charter for Agencies.

- ✓ Risk assessments carried out by the auditee's Management;
- ✓ Work already completed or planned by the European Court of Auditors (ECA) in order to avoid duplication of efforts and maximise the use of resources, providing such work is reported to the IAS on time. For Agencies having set up locally an internal audit function (IAC), the IAS will ensure a proper coordination of the audit work planned to improve the overall effectiveness and coverage of the Audit Universe and avoid potential overlapping;
- ✓ Information provided to and discussion with the Agencies' directors and Boards;
- ✓ Management requests regarding specific issues and notably the timing of the engagement (taking into consideration constraints and opportunities).

The IAS will update its risk assessment annually and seek to cover the major risk areas for each Agency. The IAS will provide guidance to its auditees through detailed recommendations as part of planned audit assurance work. Given the commitment to these coverage and planning considerations, there will be limited opportunities to respond to additional requests from management or the Boards.

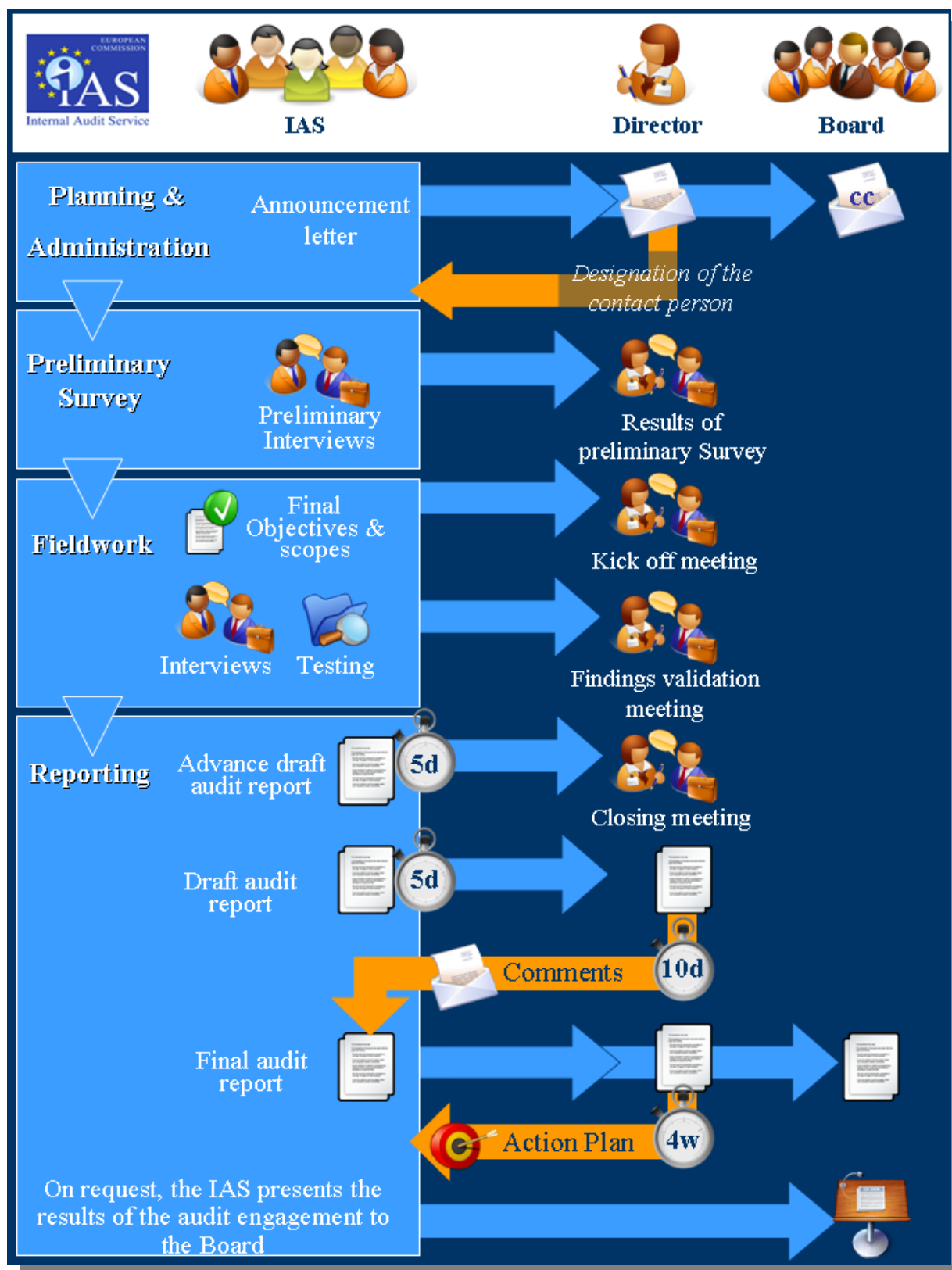


The IAS will ultimately adopt its annual plan and present it to the Management and Board of the respective Agency for approval.

The IAS may change the annual plan, in the course of a given year in response to changing conditions after informing the Director and the Board save for their disagreement.

3. AUDIT ENGAGEMENT

The chart below summarises the deliverables expected from each party during the main phases of the audit process flow.



3.1. Planning and Administration

3.1.1. Announcement Letter

At least one month prior to the start of an audit engagement, the Director-General of the IAS will send an announcement letter to the Director of the Agency, with a copy to the Chair of the Board, giving information on the audit theme, the start date and duration of the engagement and the names of the Audit Manager, Audit Team Leader and Team Members. If necessary, the Agency will be requested to provide a number of background documents needed to perform the Preliminary Survey.

The Agency will be invited to designate the contact person who will act as a facilitator. The contact person should have management's authority to discuss issues with the IAS, and be available to solve practical day-to-day issues that the IAS may encounter in conducting the engagement. His/her role is to provide support within the organisation for the audit activities undertaken. The contact person should not interfere with the audit activities and should not place any restrictions on information to be provided.

The IAS will also ask the Management to send to all staff concerned a notification of the possible use of "personal data" during the audit, as described in Council Regulation 45/2001. This notification is provided in a standard letter, which is attached to the Announcement Letter.

3.1.2. Practical Arrangements

The IAS will endeavour to minimise both unnecessary overload on the auditees and disruption of their day-to-day activities.

The IAS will discuss with the contact person the list of individuals to be interviewed, the documents needed for detailed analysis and testing, as well as logistical and practical arrangements, notably office space and equipment needs.

Special security measures can be implemented for sensitive audits e.g. encrypted emails, special protection rules, etc.

3.2. Preliminary Survey & Fieldwork

3.2.1. Preliminary Survey

The purpose of the preliminary survey is to gain a better understanding of the business process/activity/unit included in the scope of the audit and the related risks in order to refine the objectives and scope of the engagement. The preliminary survey will include a series of interviews with key staff involved in the process. The main objectives of these interviews are to:

- ✓ Get an overview of the process / sub-processes and actors involved;
- ✓ Assess the inherent risks and the key controls implemented by the Agency;
- ✓ Define the areas to be covered during the audit fieldwork as part of the objectives and scope of the engagement.

The results of this scoping exercise will be presented and discussed with the Director (or his/her delegates) at the end of the preliminary interviews. Once approved by the Director General of the IAS, the audit team will transmit by e-mail the final objectives and scope of the audit to the Director before the beginning of the audit



The purpose of the preliminary survey is to gain a better understanding of the business process. The preliminary survey includes a series of interviews with key staff involved in the process.

fieldwork.

3.2.2. *Fieldwork*

A kick off meeting⁶ is organised between the Management team of the Agency and the IAS⁷ to provide more details about the audit objectives and planned scope, the audit approach to be followed and to have an exchange of views on the audit. The IAS will be represented in this meeting by the Team Leader.

The majority of the fieldwork consists of testing using a systems audit approach which involves an assessment of the Internal Control System followed by a strength/weakness analysis (tests of procedures). Where the operation of the systems and controls are assessed as being satisfactory, tests of transactions (tests of detail) are carried out to ensure they are effectively applied.

The auditor will obtain relevant and reliable evidence to draw pertinent conclusions. The nature and extent of the tests, audit methodology adopted, and choice of interviewees will vary according to the auditor's assessment both of the area being examined and of the system of internal control.

Regular meetings to discuss the progress of the audit will be arranged during the fieldwork. The auditor will immediately report to the Agency's Management any significant weakness in the systems as these come to light. At the end of the fieldwork, a "*findings validation meeting*" will be organised with the Director of the

Agency (or his/her delegates). At this early stage, the presentation will only focus on the validation on the issues / facts identified by the audit team in the course of the fieldwork. To ensure a smooth and transparent validation process with the auditee, the results and conclusions of the validation meeting will be summarised in a presentation and sent to the Director within the week after the end of the fieldwork.

The IAS will report any suspected fraudulent activity within the agency to OLAF, and as appropriate to the director and the board of the agency whenever the audit fieldwork leads to suspicion of irregularities or fraud.



A kick off meeting can be organised to provide more details about the audit objectives and planned scope, the audit approach to be followed and to have an exchange of views on the audit and the issues of interest to the auditee.

⁶ In order to avoid unnecessary travelling the kick off meeting can take the form of a videoconference or a conference call.

⁷ The kick off meeting can only be cancelled by agreement of both parties in which case the decision has to be formally documented. The attendance of the Executive Director is optional

3.3. Reporting

The reporting process will include the following documents:

- ✓ An advance draft audit report;
- ✓ A draft audit report;
- ✓ A final audit report.

All audit reports have a marking "*limited*", whereby they should only be disseminated by recipients within their services, and on a "need-to-know basis".



During the closing meeting, the Audit Manager and the Director review the report and discuss all outstanding issues and, as a consequence, contribute to reducing the number of comments in the Agency's formal reply to the draft audit report the IAS presents

3.3.1. Advance draft report

The advance draft audit report provides the Agency with a transparent and complete overview of the results of the audit work. It will be sent after 25 working days at the latest by the Audit Manager to the Director by e-mail and will be used as a basis for discussion in the closing meeting.

3.3.2. Closing meeting

A formal closing meeting⁸ will be organised at the latest 5 working days after the transmission of the advance draft audit report. This meeting will be held with the Director of the Agency.⁹

The objective of the meeting is to review the report and to discuss all outstanding issues and, as a consequence, to contribute to reducing the number of comments in the Agency's formal reply to the draft audit report (see thereafter).

3.3.3. Draft audit report

Further to the closing meeting, the audit team will prepare the draft audit report. When possible, the report will reflect the discussions and additional evidence received during the closing meeting. The draft audit report will be sent at the latest 5 working days following the closing meeting.

The recipients of the draft audit report are:

- ✓ The Director
- ✓ The contact person

⁸ In order to avoid unnecessary travelling the closing meeting can take the form of a videoconference or a conference call.

⁹ The closing meeting can only be cancelled by agreement of both parties in which case the decision has to be formally documented.

3.3.4. *Agency's comments to the draft report*

Following the receipt of the draft audit report, the Agency will transmit to the IAS its formal comments which will be attached to the final audit report.

The comments to the draft report are expected to be received not later than 10 working days after the reception of the draft audit report.

The objective of the comments is to provide the reader of the final report with additional information (e.g. work already performed by the agency since the audit fieldwork). The comments will also mention the acceptance of individual IAS audit recommendations and, in case of rejection, provide an appropriate justification for the non-acceptance.

The comments are not an action plan and therefore should not describe what is intended to be done by the Agency in response to the audit recommendations.

3.3.5. *Final Report*

After receipt of the Agency's comments, the IAS will prepare the final audit report. This report will be sent at the latest 10 working days after the receipt of the comments.

The recipients of the final audit report are:

- ✓ The Director
- ✓ The Chairperson of the Board
- ✓ The Contact Person
- ✓ The Director CEAD Group, ECA

3.3.6. *The action plan*

The Director of the Agency will submit an action plan within 20 working days of the final report.

Both the auditor and auditee will make every effort to ensure that this timetable is

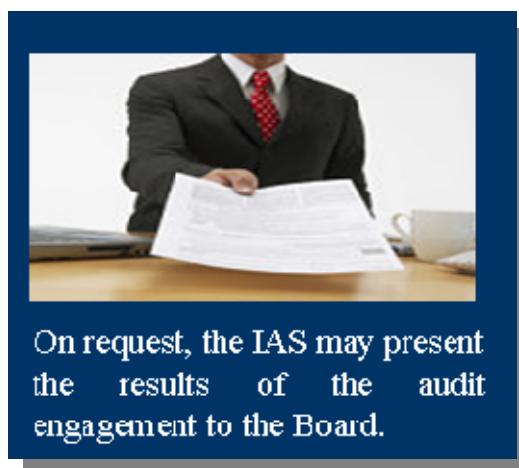
respected and that there are no delays in the validation process.

This action plan will describe in appropriate details the actions to be implemented to mitigate the risks highlighted in the final audit report. The plan shall indicate who is responsible for each action and provide an expected implementation deadline. The IAS will confirm after 20 working days at the latest that the action plan is adequate or may provide its comments.

On request, the IAS may present the results of the audit engagement and basis for its opinion to the Board.

In line with IIA standards, the auditor will inform the Board when Management accepts the risk of not taking corrective action on audit findings.

The IAS may also address a management letter¹⁰ to the Director of the Agency and/or the Chair of the Board to raise any significant issues that require their attention, but are not directly connected with the audit work performed.



¹⁰ A management letter aims at informing the management and/or the Board on issues which came to the attention of auditors in the course of their work but which are not connected to the audit work performed and therefore not substantiated by audit evidence.

3.4. Follow-up

3.4.1. Management Follow-up

It is the duty of the Management of the Agency to ensure that accepted recommendations are effectively implemented or that they have formally accepted the risk of not taking action. It is also the responsibility of Management to develop and implement an action plan¹¹ and thereafter, to organise and monitor the follow-up of the formulated and agreed-upon actions.

3.4.2. Internal Auditor's Follow-up

Unlike operational management which has a continuous monitoring responsibility, the internal auditors have an independent, or periodic monitoring responsibility based on a risk assessment. The IAS has an obligation to report to the Board on the follow-up of its recommendations.

The follow-up would normally test all audit

co-ordinator¹². If not all recommendations have been implemented after two follow-up audits and the IAS assesses the level of residual risk as high, it informs the Board and the audit is closed.

3.4.3. Annual Report

The IAS reports annually to the Director and the Board on its engagements, findings and recommendations¹³. Summaries of the individual audit reports will be attached to the Annual Report. The Annual Report also includes information on results of follow-up audits and the IAS assessment of actions taken by the auditee on those recommendations.

3.5. Quality Satisfaction Survey

Annually, as part of its quality control procedures, the IAS will send a satisfaction survey questionnaire to the Board, Management and auditees. The results of this survey will be communicated to the auditee



Depending on the level of risk associated with the observation, the follow-up will be performed in various ways:

- ✓ Follow-up by query to the co-coordinator ("chef de file") designated for reporting purposes;
- ✓ Follow-up by query and documentary or other checks to ascertain if corrective actions have been implemented on time;
- or
- ✓ Follow-up by audit in order to check that corrective action has had the desired effect, normally one year after the final report.

recommendations that were assessed as Critical and a sample or – whenever possible – all of Very Important recommendations once these have been reported as implemented by the Agency's

and be used as an additional input to improve the audit process.

¹¹ The action plan should be integrated in the Annual Management Plan(s) of the Agency and the Annual Activity Report(s) should also report on the implementation of material recommendations.

¹² The agency co-ordinator is the administrator of the IAS issue track system.

¹³ Article 72.4 of the Framework Financial Regulation

4. GENERAL RIGHTS AND OBLIGATIONS OF THE AUDITOR

4.1. Rights

In line with IIA standards¹⁴, the IAS Charter¹⁵ and relevant legislation¹⁶, the auditor:

- ✓ is independent;
- ✓ has no operational or management responsibilities or authority over any agency activities;
- ✓ is not subject to any authority that may attempt to interfere in the conduct of IAS engagements or ask the IAS to make any alterations to the content of audit reports which do not correspond to the findings and proposals made during the audits and after the validation procedure with the auditee;
- ✓ has full and unlimited access to all persons and information required for the proper performance of his/her duties.



4.2. Obligations

In line with IIA standards and Code of Ethics the auditor will:

- ✓ adequately plan, control and record his/her work;
- ✓ at all times perform his/her work objectively and impartially and free from influence or any consideration which might appear to be in conflict with this requirement. S/he will always have regard to any factors that might reflect adversely upon her/his integrity and objectivity in relation to an assignment;
- ✓ carry out his/her work by having a proper regard for the technical and professional standards expected of him/her;
- ✓ conduct himself/herself with courtesy and consideration towards all with whom s/he comes into contact in the course of his/her professional work;
- ✓ not disclose information acquired in the course of his/her work except where there is a legal duty to disclose;
- ✓ not use information acquired in the course of his/her work for his/her own personal benefit or for the advantage of any third party;
- ✓ provide the contact person(s) with a list of persons to be interviewed beforehand. It will be up to the IAS to arrange the appointments at a time suitable to both parties;
- ✓ ensure that meetings are not postponed due to unavailability of staff by providing a suitable representative;

5. GENERAL RIGHTS AND OBLIGATIONS OF THE AUDITEE

5.1. Rights

The auditee:

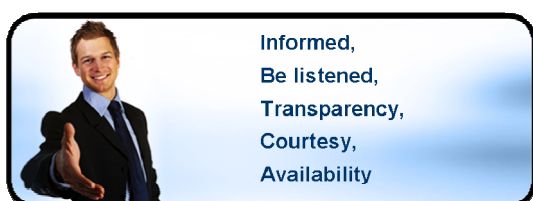
- ✓ will be kept fully informed of the progress of the assignment;

¹⁴ www.theiia.org

¹⁵ SEC(2000)1801/2

¹⁶ See Art. 86.2 of the Financial Regulation (EC, Euratom) n° 1605/2002 and Art. 72.2 of the framework Financial Regulation (EC, Euratom) n° 2343/2002

- ✓ will participate in regular validation meetings or other validations processes, e.g. exchange of electronic mail, with the auditor;
- ✓ can, at the discretion of the auditor, be provided with his/her working papers, including evidence gathered to support weaknesses mentioned in the observation forms;
- ✓ will have access to the Audit Manager at all times to discuss issues of concern to him/her and if necessary, to the Horizontal Affairs Director or the Director-General of the IAS.



5.2. Obligations

The auditee:

- ✓ will give the auditor the necessary freedom with which to exercise his/her professional independence when collecting and assessing audit evidence. The auditee should therefore ensure that there are no attempts to restrict the rights and duties of the auditor. Independence also means that the auditor should be free to operate without being subject to pressure and intimidation from the Management;

- ✓ will conduct himself/herself with courtesy and consideration towards the members of the audit team;
- ✓ should ensure that the auditor is not knowingly misled or have facts misrepresented to him/her and should use due professional care to avoid doing so unintentionally;
- ✓ should ensure that observers attending meetings are authorised by the auditors and do not hinder their work;
- ✓ will ensure that meetings, are not postponed due to unavailability of staff by providing a suitable representative;
- ✓ can be asked to approve minutes of meetings and interview notes which, in principle, should be approved within 5 working days or within a timescale to be agreed upon in the meeting or interview. However, observation forms should be validated within 5 working days. The auditor's working papers are not to be validated by the auditees;

6. CONFLICT RESOLUTION

Any conflict between an auditor and auditee should in the first instance be resolved by the Audit Team Leader and the contact person. If no solution can be found at this level, it should be escalated to the Director of the Agency and Audit Manager or above.

ANNEX I: TYPES OF ASSURANCE AUDIT ENGAGEMENTS

The assurance audit engagements to be performed by the IAS would normally consist of the following audits on individual Agencies or on crosscutting processes (e.g. accounting, IT Governance, etc.). The IAS may adopt any audit approach it deems necessary in any area of the Agency's work covering all aspects of internal control and includes:



- Internal Control System overview audit (to assess the adequacy, effectiveness and efficiency of the internal control system of the Agency on the basis of the Internal Control Standards);
- Financial audit (to determine whether the overall financial statements are stated in accordance with specific criteria such as generally accepted accounting principles);
- Operational audit (a review of any part of an organisation's operating procedures and methods for the purpose of assessing efficiency, effectiveness and economy);
- Compliance audit (to determine whether the auditee respects specific procedures or rules applicable in the context);
- Informatics audit (audit of IT and related systems);
- Governance audit;
- Audit of risk management framework;
- Integrated audit (a combination of the above audits);
- Follow-up of the effective implementation of audit recommendations through review of action plans set up by the auditee.