



POSITION PAPER

FOLLOW-UP MONITORING

ENHANCING GOVERNANCE THROUGH
INTERNAL AUDIT

ABOUT ECIIA

The European Confederation of Institutes of Internal Auditing (ECIIA) is the professional representative body of 35 national institutes of internal audit in the wider geographic area of Europe and the Mediterranean basin. The mission of ECIIA is to be the consolidated voice for the profession of internal auditing in Europe by dealing with the European Union, its Parliament and Commission and any other appropriate institutions of influence.

The primary objective is to further the development of corporate governance and internal audit through knowledge sharing, key relationships and regulatory environment oversight.

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ECIIA Head Office:

c/o IIA Belgium
Koningsstraat 109-111
Bus 5, BE-1000
Brussels, Belgium

Phone: +32 2 217 33 20
Fax: +32 2 217 33 20
TR: 849170014736-52

www.eciia.eu

INTRODUCTION

ECIIA set up a Banking Committee in 2015 with Chief Audit Executives of European Central Bank Supervised Banks¹. See the European Central Bank website for a [full list of supervised entities](#).

The mission of the ECIIA Banking Committee is:

“To be the consolidated voice for the profession of internal auditing in the Banking Sector in Europe by dealing with the European Regulators and any other appropriate institutions of influence and to represent and develop the Internal Audit profession and good Corporate Governance in the Banking Sector in Europe”

The paper describes best practice from the practitioners, but it is important to note that, depending on the culture, size, business and local requirements, other options are possible.

Thesis

Potential improvements are presented to the auditee by means of a recommendation mainly based on an audit finding. An audit report generally includes the management action defined as a response to the recommendation, together with a due date and an action owner.

Every internal audit function should have a process for monitoring follow-up on implementation of management actions. This can be an indicator for the Internal audit function's effectiveness.

This paper relates specifically to the follow-up of findings and recommendations issued by internal audit, not those identified by first or second line of defence functions. It can also be applied to actions taken in response to issues identified by regulators or external auditors.

Implementation of management actions is a first line or second line of defence responsibility. However, in case of insufficient implementation of management actions, the Internal audit function should investigate and document the reason. Therefore, a well-established follow-up monitoring process is crucial to evaluate an internal audit's effectiveness.

Background

The related IIA International Professional Practices Framework (IPPF) 2017 text is as follows:

2500 - Monitoring Progress

The Chief Audit Executive must establish and maintain a system to monitor the disposition of results communicated to management.

2500.A1 – The Chief Audit Executive must establish a follow-up process to monitor and ensure that management actions have been effectively implemented or that senior management has accepted the risk of not taking action.

2600 - Communicating the acceptance of risks²

When the Chief Audit Executive concludes that management has accepted a level of risk that may be unacceptable to the organisation, the Chief Audit Executive must discuss the matter with senior management. If the Chief Audit Executive determines that the matter has not been resolved, the Chief Audit Executive must communicate the matter to the board.

¹ Chief Audit Executives from DZ Bank AG, Crédit Agricole SA, ABN AMRO, Grupo Santander, UniCredit S.p.A., KBL European Private Bankers, Nordea, National Bank of Greece.

² IPPF 2600 Interpretation “The identification of risk accepted by management may be observed through an assurance or consulting engagement, monitoring progress on actions taken by management as a result of prior engagements, or other means. It is not the responsibility of the Chief Audit Executive to resolve the risk.”

FUNDAMENTALS

1 The effectiveness of an internal audit function can be measured among others through follow-up monitoring of management actions following recommendations.

An audit finding results from a process of evaluating audit evidence, comparing it against audit criteria, and identifies improvement potential, presented by means of a recommendation. An audit report generally includes management actions based on recommendations, together with a due date and action owner. Often audit findings are rated High, Medium or Low risk.

As part of the audit cycle, the Internal audit function must establish a follow-up process to monitor the issues identified in the audit engagements and the recommendations that address these findings. In general, the follow-up monitoring process is focused on High and Medium risk findings.

Supervisory findings and corresponding actions are important for banks. In this context it may be considered to include these in the regular Internal audit function follow-up monitoring process, not only for the ECB recommendations, but also for those of other local supervisors. Finally, this paper could also apply to other external agents that issue recommendations or best practices related to internal control matters, the most significant being the external auditors.

In some banks, the second line of defence performs follow-up monitoring of actions related to issues raised by supervisors and/or external agents. When the Internal audit function does not perform this part of the follow-up monitoring, the Internal audit function should review implementation as part of the audit engagement to evaluate the control environment and, additionally, as part of the risk assessment.

2 To enable follow-up monitoring, audit findings need to be translated into smart management actions, completed until a specified due date by the respective action owner. Risk acceptance should be reviewed by the internal auditor.

The translation of the internal audit finding could be made by an agreed text that could be labelled as a 'recommendation' or directly by action plans to the management that should be reviewed by the Internal audit function. The actions schedule is a fundamental aspect of audit engagements. In fact, monitoring the actions undertaken by management indicates management's awareness and risk culture, together with other aspects of the issues raised by the Internal audit function.

Adequate monitoring of the management actions issued by the Internal audit function should start with formal acceptance of the management actions (or recommendations) by the action owners (with a signature or equivalent process) and continue with a review of the action plan designed by the action owners to resolve identified weaknesses. If feasible, the approved action plan can already be presented in the individual audit report.

The follow-up monitoring process should be automated as much as possible, considering the size and complexity of the institution and the nature and volume of the recommendations made. An automated tracking system, with access given to all the parties involved, could be useful in establishing an efficient monitoring process, accurate reporting and evidence recording.

Risk acceptance

In case of risk acceptance of a finding by senior management, the Internal audit function will review the risk acceptance procedure and process with senior management. If they disagree, the matter will be escalated to the board.

3 Management actions reported 'Closed' should be validated by the Internal audit function.

The Internal audit function must establish a periodic monitoring procedure. This procedure could vary in intensity according to a risk-based approach depending on the type of finding, recommendation or action (considering importance, impact, etc.).

This procedure requires the implementation status of the action plans to be updated as frequently as possible. The closing of the findings and the action plan should follow a formal process. Validating the proper closure of actions could be performed by periodic monitoring or as a separate engagement. In certain cases, due to the complexity of the testing to be done, this validation usually takes place at the time of the next full audit engagement.

If the auditee reports a management action as completed and therefore wants to close the issue, the Internal audit function will validate this closure in an appropriate manner, filing evidence. In some cases, it is necessary to perform audit testing for follow-up at a later stage, to ensure the sustainability of the audit recommendations. The audit procedures required to validate a closed management action should be aligned with the type of improvement made. For improving the design of a control, a test-of-one may be appropriate, whereas for checking effectiveness of a control adequate testing needs to be performed. For substantial improvements or in case of a highly negative audit rating, separate follow-up audit engagements will be considered.

4 The results of follow-up monitoring need to be reported to senior management and the board. This report should, in particular, display recommendations of the Internal audit function that have not been implemented.

The Internal audit function must establish a reporting procedure for escalating the results of follow-up monitoring of at least High and Medium risk audit findings to the board, the

Audit Committee and senior management. The purpose of this report is to keep the governance bodies regularly informed about all the significant issues detected by the Internal audit function that have not been adequately resolved within the established terms, allowing them to decide on the appropriate measures to be taken. The reporting format must enable the board, Audit Committee and senior management to take appropriate and timely action, in case of insufficient progress.

Reporting to senior management and the board on the status of the implementation of actions raised by supervisors can either be part of the Internal audit function or the Risk function.

Reporting on follow-up monitoring should provide a summary of the main conclusions providing an overall picture. At the same time, it should be granular enough when necessary, giving information at a recommendation level. This reporting can be done in several ways and usually contains both quantitative and qualitative information:

- 1** Quantitatively: Periodic progress reporting, showing aggregated and detailed statistics, numbers and percentages of both pending and closed management actions, including information on ageing (period between agreeing the management action and follow-up monitoring) and overdue management actions/recommendations;
- 2** Qualitatively: general progress on all pending and closed actions highlighting main issues to be solved or points of concern, providing detailed information on the status of progress, steps taken and the reasons for delays, if any.

It is desirable that management's progress is taken into account when assessing senior management's awareness and risk culture. Although the first line of defence is responsible for implementing the management actions and for establishing the necessary controls or mitigating actions, a low level of implementation could indicate an ineffective Internal audit function. For example, it could imply a lack of organisational independence of the function, inadequate escalating and reporting procedures, weak monitoring processes, etc.

OUR MISSION

To be the consolidated voice for the profession of internal auditing in Europe by dealing with the European Union, its Parliament and Commission and any other appropriate institution of influence and to present and develop the internal audit profession and good corporate governance in Europe.

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of Internal Auditing (ECIIA)

c/o IIA Belgium
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