



# PRACTICE GUIDE

## Formulating and Expressing Internal Audit Opinions

**Table of Contents**

|   |           |
|---|-----------|
| <b>1. Executive Summary .....</b>                                       | <b>1</b>  |
| <b>2. Introduction.....</b>   | <b>2</b>  |
| <b>3. Planning the Expression of an Opinion</b>                         | <b>3</b>  |
| 3.1 Expressing an Opinion   | 4         |
| 3.2 Scope of Opinions   | 5         |
| 3.3 Establishing Suitable Criteria for the Opinion                      | 6         |
| <b>4. Scope of Work .....</b>   | <b>8</b>  |
| 4.1 Evaluation of Results   | 8         |
| <b>5. Use of Grades in Expressing an Opinion</b>                        | <b>10</b> |
| 5.1 Use of Negative (Limited) Assurance Opinion and “Informal” Opinions | 10        |
| 5.2 Reliance on the Work of Others When Supporting an Opinion           | 11        |
| <b>Appendix A: Examples: Risk Ratings or Rankings</b>                   | <b>13</b> |
| <b>Appendix B: Examples: Micro and Macro Audit Opinion (Grading)</b>    | <b>15</b> |
| <b>Appendix C: Macro-level Opinion (Example)</b>                        | <b>18</b> |
| <b>Appendix D: Related IPPF Guidance.....</b>                           | <b>19</b> |



## 1. Executive Summary

**Nature of this Guidance:** This document provides practical guidance to internal auditors who wish to form and express an opinion on some or all of an organization's governance, risk management, and internal control systems.

This guidance is not intended to represent all of the considerations that may be necessary. Some of the related *International Standards for the Professional Practice of Internal Auditing (Standards)* and other guidance documents related to this topic are provided in Appendix D.

### Applicability

This guidance may be applicable to and useful for:

- Chief audit executives (CAEs).
- Boards.
- Executive and operating management.
- Other assurance providers (OAPs).
- Other professional and regulatory bodies.

### **Background**

Internal auditors are being asked by the board, management, and other stakeholders to provide opinions as part of each individual audit report as well as on the overall adequacy of governance, risk management, and control within the organization. These requests may be for an assurance or opinion at a broad level for the organization as a whole (macro-level opinion) or on individual components of the organization's operations (micro-level opinion).

Examples of macro- and micro-level opinions include:

- An opinion on the organization's overall system of internal control over financial reporting (macro).
- An opinion on the organization's controls and procedures for compliance with applicable laws and regulations, such as health and safety, when those controls and procedures are performed in multiple countries or subsidiaries (macro).
- An opinion on the effectiveness of controls such as budgeting and performance management, when such controls are performed in multiple subsidiaries and coverage comprises the majority of the organization's assets, resources, revenues, etc. (macro).
- An opinion on an individual business process or activity within a single organization, department, or location (micro).
- An opinion on the system of internal control at a subsidiary or reporting unit, when all work is performed in a single audit (micro).
- An opinion on the organization's compliance with policies, laws, and regulations regarding data privacy, when the scope of work is performed in a single or just a few business units (micro).

## 2. Introduction

The need for audit opinions and the ability of internal auditing to express them depends on several circumstances, including understanding the needs of stakeholders; determining the scope, nature, timing, and extent of audit work required; ensuring there are sufficient resources to complete the work; and assessing the results of the work performed.

Stakeholder requirements for internal audit opinions, including the level of assurance required, should be clarified by the CAE with senior management and the board.

Discussions with stakeholders may include:

- The value of the opinion to the stakeholders, including (where appropriate) why it is being requested.
- The timing for issuance and type of the opinion(s).
- The form of opinion to be provided (e.g., written or verbal).
- The level of assurance to be provided.
- The period or point in time the opinion covers.
- The scope of the opinion sought (e.g., whether it should be limited to financial reporting, operational controls, or compliance with specified regulations).
- The criteria used in expressing opinions.
- The rating process to be applied in relation to individual audit findings.
- Potential users of the assurance beyond management and the board.

When issuing internal audit opinions, the CAE considers the potential impact to the organization if the report is likely to be distributed to outside users. In such circumstances it would be appropriate to consult legal counsel, particularly if “privileged information” is an important factor.

### 3. Planning the Expression of an Opinion

In developing audit plans to support the expression of an opinion, there are a number of factors that the internal audit activity needs to consider. These include:

- The unique characteristics of macro-level versus micro-level opinions. Macro opinions generally are based on the results of multiple audit projects, whereas micro opinions are typically based on the results of a single audit project or a few projects performed over a limited period of time.
- The nature of the opinion to be provided; specifically, whether positive or negative assurance will be issued. In general, more evidence and a broader scope of work are required for a positive assurance opinion.
- The purpose and use of any special requests where an opinion will be rendered.
- The nature and extent of audit evidence needed to support the opinion to be provided and the time period required to perform the work. This is especially important for macro opinions, where the opinion may require multiple projects to be completed.
- Discussion and agreement with stakeholders (typically senior management and the board) on the criteria that will be used in determining the opinion to be provided.
- The need for careful planning and development of an audit plan and approach that will provide the internal audit activity with sufficient, relevant evidence to support the opinion. This approach may include aggregating the results of previously completed audits to support the opinion, or identifying areas of significance and risk where audit evidence will need to be completed or obtained to support the expression of the planned internal audit opinion. In addition, where multiple projects will be required to provide the opinion, these projects should be identified and included in the internal audit plan.
- The consideration of all related, planned projects (including reliance on the work of others or self-assessments), and allowing time for the final assessment. For example, rendering an opinion on inventory controls in a global organization (e.g., audits in 30 international locations) will require extensive planning on scope coverage and the time to complete the work before an opinion can be rendered.
- Whether there are adequate resources and skills to perform all the work required to provide sufficient support for the opinion. If not, a determination is made whether to decline to express the opinion, or to qualify the opinion (by excluding certain areas or risks from the scope of the opinion).
- Discussions with management and communication of the internal audit plan, including the timing and scope of each project and the criteria that will be used in determining the opinion to be provided to management and, if appropriate, the board.

### **3.1 Expressing an Opinion**

It is not uncommon for the internal audit activity to provide opinions at both macro and micro levels, including an opinion on the overall adequacy of the organization's policies, procedures, and processes to support governance, risk management, and internal controls. When rendered, such opinions are generally in writing and will be of the highest value if they take the form of "positive assurance," sometimes referred to as "reasonable assurance" opinions. The CAE is in the best individual to provide macro opinions given his or her position to obtain a pervasive overview of micro-level audit results.

Positive assurance (reasonable assurance) provides the highest level of assurance and one of the strongest types of audit opinions. In providing positive assurance, the auditor takes a definite position, which may be binary in nature; for example, that internal controls are or are not effective in the situation or that risks are or are not being effectively managed.

Variations in expressing a positive assurance opinion may include the use of grades, where the effectiveness of internal controls or risk management is rated using a grading system. Common examples of a grading system include the use of color coding (such as red-yellow-green) or the use of a grading scale (such as 1 to 4). When such scales are used, they should have an agreed-upon and commonly understood meaning within the organization. More guidance on the "Use of Grades" is provided in the Appendices.

The expression of the opinion may also include information about the direction of the opinion since a previous audit. For example, the opinion may indicate that controls or risk management are satisfactory, but their

effectiveness may have diminished since the prior audit period.

A positive assurance opinion requires the highest level of evidence. It implies not only whether controls/risk mitigation processes are adequate and effective, but also that sufficient evidence was gathered to be reasonably certain that evidence to the contrary, if it exists, would have been identified. The auditor takes full responsibility for the sufficiency of the audit procedures to find what should have been reasonably found by a prudent auditor.

Positive assurance opinions provide the reader a high level of confidence and comfort in the reliability of the underlying information. As such, internal audit activities are often requested to provide such positive assurance opinions.

An opinion can be *qualified* which may be useful in situations where there is an exception to the general opinion. For example, the opinion may indicate that controls were: "Satisfactory with the exception of accounts payable controls, which require significant improvement."

### 3.2 Scope of Opinions

CAEs may be requested to render opinions at an overall level (macro) or on an individual audit assignment level (micro). The following highlights distinctions between the two.

#### Macro Level

While macro-level opinions are issued or provided *at a point in time* (e.g., on an annual basis), the supporting audit evidence is generally built-up over a period of time and based on the results of several audit assignments, work performed by others, and informal evidence. A macro-level opinion may evolve or change as the individual assignments are completed and additional audit evidence (including findings/exceptions) is obtained.

When expressing a macro opinion, the CAE considers several factors:

- The purpose for which the opinion will be used.
- Whether the opinion can be rendered based on the audit period and testing timelines.
- A clear understanding of what the organization considers “overall” satisfactory performance.
- The organization’s risk appetite and the criteria for the opinion.
- The sufficiency of audit work and audit evidence (including the work of others and informal evidence) to support the opinion requested.

On occasion, internal auditing may not be able to obtain sufficient evidence (e.g., because of resource limitations) to support all the areas covered by a macro opinion. As a result, only a *limited* macro opinion may be possible; for example, an opinion on

compliance with environmental regulations may be limited by excluding an assessment with regulations governing waste disposal. The potential for a limited opinion should be recognized as part of the planning process, so that stakeholders understand the opinion will be limited.

Expressing an opinion at the macro level can be a complex task. It may require establishing methodologies and planning for:

- Aggregation and interpretation of findings from several audits, some of which may have been completed months before the opinion date. In such circumstances the CAE will have to exercise due care to ensure consistent standards have been used in all audits to assess any findings and to draw conclusions. In addition, follow-up on remedial action and subsequent events to the earlier audit should be considered.
- Methodologies for incorporating audit evidence developed through less formal means. This may occur since macro opinions are generally pervasive in nature and require a greater breadth of coverage. As such, reliance on other types of assurance processes may be required. For example, the results of management self-assessments and the consideration of informal evidence (i.e., evidence that is not specific to an audit engagement) from different sources might be utilized if the auditor believes them to be reliable. Informal evidence may include the subjective assessment of internal auditing (e.g., based on visits to locations and observations of operations), but reliance on such evidence may be disclosed when expressing the macro opinion.



3.2 continued

- Consideration of evidence that may have been obtained through reliance on the work of others. This may include, for example, a review of the work of various quality assurance groups within the organization or work completed to meet regulatory requirements, each of which may have been performed using different or varying assurance methodologies. In such situations, it is imperative that the CAE evaluates the risk associated with utilizing the work of others and consider explaining this when expressing an opinion.

Micro Level

Opinions at the micro level are generally the result of an individual audit assignment. Such an assignment may be in relation to controls around a specific process, risk, or business unit. The formulation of such opinions requires consideration of the audit findings and their respective ratings.

Micro opinions are typically less complex than macro opinions. Recent surveys indicated that most audit organizations throughout the world issue micro-level audit opinions, using a rating/grading system as part of expressing their overall opinion. However, it was also noted that many audit organizations have not developed a formal criteria framework against which to draw their conclusions.

In some organizations, where the auditor provides macro opinions on risks and the organization as a whole, individual assignment-level (micro) opinions may not be as important to senior-level stakeholders or the board because they are mostly concerned with the overall macro opinion. In such instances, it is particularly important to

manage stakeholder expectations below this senior level since stakeholders responsible for the audited areas will typically expect a report and an opinion on completion of the specific assignment.

**3.3 Establishing Suitable Criteria for the Opinion**

Auditors should have a means of measuring or judging the results and impact of matters identified on an audit. This can be achieved through the development of a criteria framework. Suitable criteria are factors that are relevant and appropriate to the particular characteristics of the audited organization and against which actual outcomes can be objectively assessed. They focus, wherever possible, on the results expected to be achieved by systems of internal controls and ideally are established before the execution of the overall audit plan. These criteria should be relevant, reliable, neutral, understandable, and complete. For example, the aggregate of the observations allows the audit team to form a conclusion against each audit objective or on a process or function taken as a whole. The CAE ensures there is an evaluation framework for this process.

As part of the planning process, the basis for the opinion is discussed with various stakeholders using the criteria and evaluation framework. This includes discussing specific objectives with key process owners, senior executives, and other stakeholders, including the board, as appropriate. It is important that management within audited organizations understand and accept these criteria and how they could impact them and their responsibility in relation to maintaining a strong internal control environment.



In establishing suitable criteria, it is important for the internal audit activity to determine whether the organization has established basic principles as to what constitutes appropriate governance, risk management, and control practices. This would include:

- A clear articulation of the definition of control adopted or used by the organization; for example, has the organization adopted the COSO or CoCo model?
- Management's understanding of what would constitute a satisfactory level of control. For example, satisfactory could mean that 90 percent (or another acceptable percentage) of transactions within one control objective are conducted in accordance with established control procedures; alternatively, it could also mean that 85 percent (or another acceptable percentage) of overall controls are working as intended.
- A clear articulation by management of its risk tolerances or appetite, including materiality thresholds.

Such key corporate principles provide an agreed-upon framework against which conclusions can be reached and an opinion expressed in a manner that is mutually understood by management and the internal auditors.

In the absence of such principles, it is recommended that internal auditing should not render an opinion, since there is no frame of reference to objectively support the internal auditor's conclusion.

#### 4. Scope of Work

The nature and form of the opinion expressed depends on the scope of work performed and audit evidence gathered. A key step in developing the scope is to design an audit plan that will result in sufficient, appropriate audit evidence that will allow the auditor to draw a conclusion on the results of audit work performed. When discussing the plan with key stakeholders, the CAE articulates precisely what is included within the scope of work and type of opinion to be rendered. This is important to communicate to key stakeholders to avoid confusion, particularly around macro-level opinions.

Consideration of the appropriateness of audit scope is required for both micro- and macro-level opinions. However, with macro opinions this becomes more complex. Whether a macro-level opinion on governance, risk management, and control is possible will depend on the completeness of the audit universe and the auditor's coverage of the universe. The expression of a macro-level opinion may take longer to complete as a result of the extent of work that will need to be completed and the need to aggregate the results of several individual audits that collectively will support the macro-level opinion.

Common elements included in defining the scope over which the opinion applies are:

- Descriptions of the portions of the organization being covered, whether the scope is defined as the organization as a whole or just specific components of the organization, high level risks (e.g., competitor actions), or risk categories (e.g., credit risk).
- Control components covered by the audit; that is, the specific financial, operational, or compliance controls being addressed (e.g., specifically stating that the opinion relates to design processes, performance objectives, documentation requirements, financial results, etc.).
- The point of time or the time period over which the opinion is expressed.

##### 4.1 Evaluation of Results

An important step in the planning process is the establishment of a methodology that will be followed to evaluate the results of audit work completed. This may involve assessing and rating individual audit findings and their significance relative to the individual project, individual risks/risk categories, or the organization as a whole.

The following elements should be considered:

**Materiality** – The magnitude or significance of a key business objective that is fundamental to the opinion is important. The internal auditor should consider the magnitude of the residual risk that a business objective will not be achieved.

**Impact** – The implication of audit issues/findings are considered and fully understood in the context of the opinion to be given (i.e., micro versus macro). An audit opinion may be given a different level of importance using the same rating criteria depending on the impact to the organization. For example, some issues may have a material impact on the achievement of goals or mitigation of risks at a micro level, but not at a macro level (e.g., the failure to manage potential duplicate payments may be material to a subsidiary but not to the organization as a whole).

Another factor to be considered when rating the adequacy of controls in a macro opinion is rating the level of risks provided by the controls in place so that management's objectives will be achieved. (Examples of risk ratings are presented in Appendix A.)

## 5. Use of Grades in Expressing an Opinion

It is common for internal audit activities to use a grading system when issuing audit reports.

When using a grading system to communicate a positive assurance opinion, care must be taken with wording, particularly around defining “waterlines” such as adequate or inadequate. Wording should be clear and appropriately defined for the reader. Using general terms such as *satisfactory*, *effective*, or *unsatisfactory* may not sufficiently define the meaning. The organization needs to have a clear, common understanding of these terms and what constitutes an acceptable level of performance, all of which require a frame of reference. For example, the term *effective* usually refers to controls being effective both in design and in operation. The opinion needs to indicate whether both meanings are included.

Clarity of communication is improved if the organization has adopted a broadly understood definition of internal controls, such as in the COSO model. In preparing the report, the CAE ensures that any technical terms (e.g., *material weakness*) are clearly defined for the reader. Developing a guideline such as those included in the Appendices will eliminate some of the subjectivity and help avoid confusion.

Use of a grading scale generally requires a well-defined evaluation structure. For example, an opinion that merely states that internal controls meet minimum defined criteria would not require as much evidence as an opinion that stated how much better or worse internal controls are than a defined benchmark.

Increased precision in the information provided in an opinion normally increases the amount of evidence needed to support the opinion. Providing a grade as part of a positive assurance opinion may provide useful information to the reader, but sufficient evidence is needed to support that finer level of detail given in the opinion. The rating scale clarifies whether the opinion is in relation to the organization as a whole or on the subject of the audit (specific audit assignment).

It is also important to consider consistency and sustainability of the grading or rating system across audit years. Grading or rating systems that change too frequently can be confusing to the stakeholders and may impact the comparability and clarity of reporting across the organization.

### 5.1 Use of Negative (Limited) Assurance Opinions and “Informal” Opinions

A “negative assurance,” sometimes referred to as “limited assurance,” opinion is a statement that nothing came to the auditor’s attention about a particular objective, such as the effectiveness of a system of internal control, adequacy of a risk management process, or on any other specific matter. The internal auditor takes no responsibility for the sufficiency of the audit scope and procedures to find all significant concerns or issues. Such an opinion is generally considered less valuable than positive assurance and therefore auditors consider their value before rendering them.

Occasionally, internal auditing may be asked for an “informal” or verbal opinion on the adequacy of governance, risk management, or control policies and processes, either at the macro or micro level. Where possible, the expression of such an opinion should not be subjective in nature, but should be based on objective evidence (as discussed previously). However, where stakeholders would accept a more subjective opinion, the fact that the opinion is subjective should be clearly disclosed with any verbal commentary.

When expressing an informal opinion, the CAE considers a number of factors:

- The sufficiency of audit work (including the work of others and informal evidence) to support the opinion requested.
- Whether the opinion can be delayed until additional evidence is obtained.
- The criteria for the opinion and a clear understanding of what the organization considers satisfactory performance.
- The organization’s risk appetite.
- The purpose for which the opinion will be used.
- Whether the informal opinion will be positive or negative in nature.
- Whether the opinion will be limited and put in the context of what supporting evidence has and has not been obtained (e.g., “This opinion is based on the seven audits completed this year. We have not completed audits of the XYZ subsidiary, and our opinion does not extend to it”).

In essence the factors considered are the same as those that would be considered in expressing a written opinion.

It will be important to recognize instances where the most appropriate response is an indication that further work would be needed to express an opinion on the area subject to discussion.

In some instances, it may be necessary for internal auditing to decline to issue a verbal opinion, especially when there is a lack of sufficient evidence or work to support the opinion.

## **5.2 Reliance on the Work of Others When Supporting an Opinion**

In many organizations, there are a range of functions or people who provide management and the board with assurance on specific aspects of the organization’s operations, commonly referred to as “other assurance providers” (OAPs).

If the CAE intends to rely on this work for purposes of expressing his or her own opinion, appropriate steps should be taken, including assessing the competency, independence, and objectivity of the OAPs. The CAE:

- Determines that the OAP possesses the knowledge, skills, and other competencies necessary for the work to be relied upon.
- Assesses the organizational relationships of the OAP to determine that there are no relationships that will prevent the OAP from rendering impartial and unbiased judgments and opinions in the performance of their assurance activities.
- Obtains sufficient information regarding the objectives and scope of the OAP’s work to confirm that they meet auditing’s specific requirements. A common best practice is to establish frequent communication meetings where the CAE has visibility of the planned activities, results of work, and OAP reports (or other similar communications).
- Evaluate the risks of using the work of OAPs, particularly related to the level of assurance and confidence related to opinions.

Once the CAE determines he or she will rely on the work of others, that fact should be included in discussions with key stakeholders and, if significant, the board. It is important that all parties understand how the work of OAPs may impact macro or micro audit opinions, including the degree of confidence to be placed in such opinions.

### **5.3 Guidance From Regulators and Other Standard Setters**

To the extent practicable, this guidance aims to harmonize with other global regulators and is not intended to conflict with known laws and regulations from other regulatory bodies and standard setters. Internal auditors are not to overlook their responsibilities to comply with local laws and regulations. However, where such regulations or laws do not exist or may conflict, this guidance can be useful for providing audit opinions to all practitioners who aim to comply with this guidance to the extent practicable.

### **5.4 Other Legal Considerations**

The use of opinions can result in increased reliance on internal audit reports. This is a desirable outcome as it increases the value and clarity on the level of assurance given in an audit report. However, increased reliance can also result in legal and other ramifications if someone relies on the audit report and a control failure emerges after the report is issued. In addition, the CAE's own personal certification credentials can have legal ramifications if noncompliance issues should arise. In managing these ramifications, the CAE is encouraged to use appropriate language in the report and any disclaimer that puts the reader on notice of any limitations to the level of assurance given. When signing a report opinion as a chartered accountant, certified public accountant, certified internal

auditor, or other similarly credentialed professional, the CAE should alert readers that it is not possible to provide absolute assurance and encourage them to consider all legal implications. By being clear on these matters and documenting them to the users of reports, the CAE is able to manage expectations and limit unnecessary legal risk.

## **Appendix A: Examples: Risk Ratings or Rankings**

The following are examples of systems that may be applied to rate or rank risks. For all of these, it is important to clarify context (i.e., rating relative to the organization as a whole versus the subject of the audit). These risk ratings/rankings may also be applicable to certain micro-level opinions.

### **Company A: Risk Rating Opinion**

**Very High** – The residual risk after consideration of the adequacy and/or effectiveness of controls/risk mitigators remains very high according to the organization's (or division's or entity's) risk assessment matrix (risk rating criteria). This is above the acceptable tolerance level.

**High** – The residual risk after consideration of the adequacy and/or effectiveness of controls/risk mitigators remain high according to the organization's (or division's or entity's) risk assessment matrix. This is above the acceptable tolerance level.

**Medium** – The residual risk after consideration of the adequacy and/or effectiveness of controls/risk mitigators is medium according to the organization's (or division's or entity's) risk assessment matrix and thus is within the organization's risk tolerance.

**Low** – The residual risk after consideration of the adequacy and/or effectiveness of controls/risk mitigators is low and thus is within the organization's risk tolerance.

## **Company B: Deficiency Risk Rating in Relation to Audit Findings (Micro Level)**

**High Priority Risk** – As this is a high priority issue, immediate management attention is required. This is a serious internal control or risk management issue that if not mitigated, may, with a high degree of certainty, lead to:

- Substantial losses, possibly in conjunction with other weaknesses in the control framework or the organizational entity or process being audited.
- Serious violation of corporate strategies, policies, or values.
- Serious reputation damage, such as negative publicity in national or international media.
- Significant adverse regulatory impact, such as loss of operating licenses or material fines.

**Medium Risk** – As this is a medium-priority issue, timely management attention is warranted. This is an internal control or risk management issue that could lead to:

- Financial losses (stipulate levels).
- Loss of controls within the organizational entity or process being audited.
- Reputation damage, such as negative publicity in local or regional media.
- Adverse regulatory impact, such as public sanctions or immaterial fines.

**Low Risk** – As this is a low priority issue, routine management attention is warranted. This is an internal control or risk management issue, the solution to which may lead to improvement in the quality and/or efficiency of the organizational entity or process being audited. Risks are limited.



**Company C:- Priority Risk Ranking of a Deficiency (Micro Level)**

Any one or more criteria noted below will result in a priority ranking providing mitigating controls are not in place: *(Note: Two or more priority ranking observations can result in an “unsatisfactory” audit opinion.)*

- There is a potential financial statement or financial disclosure misstatement requiring an after-tax adjustment to the financial statements or related disclosures greater than or equal to \$XX million.
- Controls are not operating as intended and it is estimated that there could be an operational effectiveness and efficiency opportunity having a potential economic impact greater than 0.5 percent of total net income or greater than 1 percent of a group classification of balance sheet accounts such as fixed assets, current assets, current liabilities, etc., or have a material adverse effect on the company's reputation.
- A key control is not functioning as intended as supported by the auditors' test exception results in excess of XX percent (using a sufficient representative sample size), and no mitigating controls exist (or a lower test exception rate if exposure is significant).
- Critical information systems (as defined) are significantly compromised due to ineffective controls over logical/application security, data protection (including customer/employee information), and a lack of system edit checks and limited mitigating controls.
- Priority control weaknesses identified in a previous internal audit remain unresolved without a reasonable cause for delay.
- Audit findings have identified ineffective controls that have led to an internal or

external fraud (as defined being perpetrated (i.e., proven) or there is a high likelihood that a potential (i.e., credible) fraud could exist that is greater than \$XX.

**Appendix B: Examples: Micro and Macro  
Audit Opinion (Grading)**

The following are grading examples that may be applied in relation to audit opinions. For all of these, it is important to clarify context; that is, opinion relative to the organization as a whole (macro) versus an individual audit review of a particular subject or process (micro). It will be important to have a risk ranking process and methodology in place, similar to those in Appendix A, when formulating these opinions.

**Company D: 3 Tier Grading**

**Inadequate System of Internal Control -**


Findings indicate significant control weaknesses and the need for urgent remedial action. Where corrective action has not yet started, the current remedial action is not, at the time of the audit, sufficient or sufficiently progressing to address the severity of the control weaknesses identified.

**Adequate System of Internal Control**

**Subject to Reservations** – A number of findings, some of which are significant, have been raised. Where action is in progress to address these findings and other issues known to management, these actions will be at too early a stage to allow a satisfactory audit opinion to be given.

**Satisfactory System of Internal Control -**

Findings indicate that on the whole, controls are satisfactory, although some enhancements may have been recommended.



### Company E:- 4 Tier Grading

|                                 |   |
|---------------------------------|---|
| <b>Effective</b>                | Controls evaluated are adequate, appropriate, and effective to provide reasonable assurance that risks are being managed and objectives should be met.  |
| <b>Some Improvement Needed</b>  | A few specific control weaknesses were noted; generally however, controls evaluated are adequate, appropriate, and effective to provide reasonable assurance that risks are being managed and objectives should be met. |
| <b>Major Improvement Needed</b> | Numerous specific control weaknesses were noted. Controls evaluated are unlikely to provide reasonable assurance that risks are being managed and objectives should be met.   |
| <b>Unsatisfactory</b>           | Controls evaluated are not adequate, appropriate, or effective to provide reasonable assurance that risks are being managed and objectives should be met.   |

**Company E:- 5 Tier Grading With Scale**

| <b>Evaluation and Grading Matrix</b>            |                               |                                   |                                   |  |
|---|-------------------------------|-----------------------------------|-----------------------------------|--|
| Scope of Work Determinants                      | Well-Controlled<br><b>(A)</b> | Satisfactory — High<br><b>(B)</b> | Satisfactory — Low<br><b>(C)</b>  | Material Opportunities for Improvement<br><b>(F)</b> |
| Operating Effectiveness and Efficiency          | Effective                     | Adequate                          | Serious Problems but Not Material | Disclosure   |
| Reliability of Financial Reporting              | Effective                     | Adequate                          | Serious Problems but Not Material | Disclosure   |
| Compliance With Applicable Laws and Regulations | Effective                     | Adequate                          | Serious Problems but Not Material | Disclosure   |
| Safeguarding of Assets                          | Effective                     | Adequate                          | Serious Problems but Not Material | Disclosure   |



## **Appendix C: Macro-level Opinion** **(Example)**

***Note: It is necessary to have a methodology and process in place to evaluate the cumulative results of audit assignments and audit findings to express such an opinion.***

To: Chair, Audit Committee  
From: Head of Internal Audit

Subject: Internal Audit of (subject matter or other entity) for the period ended \_\_\_\_

We have completed the internal audit plan of (state the subject matter or other entity). The objective(s) of this engagement was (were) to (list the broad audit objective(s)).

The plan was prepared considering (state primary drivers used to develop the plan). The internal audit was conducted in accordance with the *International Standards for the Professional Practice of Internal Auditing*.

The internal audit examined (describe what has been examined; e.g., the management control framework, the risk assessment strategy, policies and practices, information used for decision making, reporting as applicable to the entity examined, etc.).

The scope of the audit included (scope inclusions). Furthermore, the examination covered activities that have occurred during the period (period covered by the examination).

The criteria used to assess the entity were (describe the criteria and their source). The criteria were discussed and agreed with management (define who) before the conduct of detailed audit procedures.

We concluded that (insert a positive opinion/grade for each objective). Our overall opinion on XXX is satisfactory or unsatisfactory (base the overall opinion of the entity through evaluation of specific audit objective opinions).

In my professional judgment as (title), sufficient and appropriate audit procedures have been conducted and evidence gathered to support the accuracy of the conclusions reached and contained in this report. The conclusions were based on a comparison of the situations as they existed at the time against the audit criteria. The conclusions are only applicable for the entity examined. The evidence gathered meets professional audit standards and is sufficient to provide senior management with proof of the conclusions derived from the internal audit.

## **Appendix D: Related IPPF Guidance**

Related IPPF mandatory guidance includes:

2010 – Planning: “The CAE must establish risk-based plans to determine the priorities of the internal audit activity, consistent with the organization’s goals.”

2410.A1 – Criteria for Communicating: “Final communication of engagement results must (where appropriate) contain the internal auditor’s overall opinion and/or conclusion.”

2120 – Risk Management: “The internal audit activity should monitor and evaluate the effectiveness of the organization’s risk management system.”

2120. A1 – The internal audit activity must evaluate risk exposures relating to the organization’s governance, operations, and information systems regarding the:

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

2130. A1 – The internal audit activity must evaluate the adequacy and effectiveness of controls in responding to risks within the organization’s governance, operations, and information systems regarding the:

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

Related IPPF strongly recommended guidance includes:

Practice Advisory 1210.A1-1 - Obtaining External Service Providers to Support or Complement the Internal Audit Activity. It also embodies concepts from the following AICPA’s Auditing Standards: SAS 65 - The Auditor’s Consideration of the Internal Audit Function in an Audit of Financial Statements and SAS 73 - Using the Work of Others

Practice Advisory 1210.A1-1: Obtaining External Service Providers to Support or Complement the Internal Audit Activity

1. Each member of the internal audit activity need not be qualified in all disciplines. The internal audit activity may use external service providers or internal resources that are qualified in disciplines such as accounting, auditing, economics, finance, statistics, information technology, engineering, taxation, law, environmental affairs, and other areas as needed to meet the internal audit activity’s responsibilities.
2. An external service provider is a person or firm, independent of the organization, who has special knowledge, skill, and experience in a particular discipline. External service providers include actuaries, accountants, appraisers, culture or language experts, environmental specialists, fraud investigators, lawyers, engineers, geologists, security specialists, statisticians, information technology specialists, the organization’s external auditors, and other audit organizations. An external service provider may be engaged by the board, senior management, or the chief audit executive (CAE).

3. External service providers may be used by the internal audit activity in connection with, among other things:

- Achievement of the objectives in the engagement work schedule.
- Audit activities where a specialized skill and knowledge are needed such as information technology, statistics, taxes, or language translations.
- Valuations of assets such as land and buildings, works of art, precious gems, investments, and complex financial instruments.
- Determination of quantities or physical condition of certain assets such as mineral and petroleum reserves.
- Measuring the work completed and to be completed on contracts in progress.
- Fraud and security investigations.
- Determination of amounts, by using specialized methods such as actuarial determinations of employee benefit obligations.
- Interpretation of legal, technical, and regulatory requirements.
- Evaluation of the internal audit activity's quality assurance and improvement program in conformance with the *Standards*.
- Mergers and acquisitions.
- Consulting on risk management and other matters.

4. When the CAE intends to use and rely on the work of an external service provider, the CAE needs to consider the competence, independence, and objectivity of the external service provider as it relates to the particular assignment to be performed. The assessment of competency, independence, and objectivity is also needed when the external service provider is selected by

senior management or the board, and the CAE intends to use and rely on the external service provider's work. When the selection is made by others and the CAE's assessment determines that he or she should not use and rely on the work of the external service provider, communication of such results is needed to senior management or the board, as appropriate.

5. The CAE determines that the external service provider possesses the necessary knowledge, skills, and other competencies to perform the engagement by considering:

- Professional certification, license, or other recognition of the external service provider's competence in the relevant discipline.
- Membership of the external service provider in an appropriate professional organization and adherence to that organization's code of ethics.
- The reputation of the external service provider. This may include contacting others familiar with the external service provider's work.
- The external service provider's experience in the type of work being considered.
- The extent of education and training received by the external service provider in disciplines that pertain to the particular engagement.
- The external service provider's knowledge and experience in the industry in which the organization operates.



6. The CAE needs to assess the relationship of the external service provider to the organization and to the internal audit activity to ensure that independence and objectivity are maintained throughout the engagement. In performing the assessment, the CAE verifies that there are no financial, organizational, or personal relationships that will prevent the external service provider from rendering impartial and unbiased judgments and opinions when performing or reporting on the engagement.
7. The CAE assesses the independence and objectivity of the external service provider by considering:
  - The financial interest the external service provider may have in the organization.
  - The personal or professional affiliation the external service provider may have to the board, senior management, or others within the organization.
  - The relationship the external service provider may have had with the organization or the activities being reviewed.
  - The extent of other ongoing services the external service provider may be performing for the organization.
  - Compensation or other incentives that the external service provider may have.
8. If the external service provider is also the organization's external auditor and the nature of the engagement is extended audit services, the CAE needs to ascertain that work performed does not impair the external auditor's independence. Extended audit services refer to those services beyond the requirements of audit standards generally accepted by external auditors. If the organization's external auditors act or appear to act as members of senior management, management, or as employees of the organization, then their independence is impaired. Additionally, external auditors may provide the organization with other services such as tax and consulting. Independence needs to be assessed in relation to the full range of services provided to the organization.
9. To ascertain that the scope of work is adequate for the purposes of the internal audit activity, the CAE obtains sufficient information regarding the scope of the external service provider's work. It may be prudent to document these and other matters in an engagement letter or contract. To accomplish this, the CAE reviews the following with the external service provider:
  - Objectives and scope of work including deliverables and time frames.
  - Specific matters expected to be covered in the engagement communications.
  - Access to relevant records, personnel, and physical properties.
  - Information regarding assumptions and procedures to be employed.
  - Ownership and custody of engagement working papers, if applicable.
  - Confidentiality and restrictions on information obtained during the engagement.
  - Where applicable, conformance with the *Standards* and the internal audit activity's standards for working practices.

10. In reviewing the work of an external service provider, the CAE evaluates the adequacy of work performed, which includes sufficiency of information obtained to afford a reasonable basis for the conclusions reached and the resolution of exceptions or other unusual matters.

When the CAE issues engagement communications, and an external service provider was used, the CAE may, as appropriate, refer to such services provided. The external service provider needs to be informed and, if appropriate, concurrence should be obtained before making such reference in engagement communications.

## ABOUT THE INSTITUTE

Established in 1941, The Institute of Internal Auditors (IIA) is an international professional association with global headquarters in Altamonte Springs, Fla., USA. The IIA is the internal audit profession's global voice, recognized authority, acknowledged leader, chief advocate, and principal educator.

## ABOUT PRACTICE GUIDES

Practice Guides provide detailed guidance for conducting internal audit activities. They include detailed processes and procedures, such as tools and techniques, programs, and step-by-step approaches, as well as examples of deliverables. Practice Guides are part of The IIA's International Professional Practices Framework. As part of the Strongly Recommended category of guidance, compliance is not mandatory, but it is strongly recommended and the guidance is endorsed by The IIA through formal review and approval process.

For other authoritative guidance materials provided by The IIA please visit our Web site, [www.theiia.org/guidance](http://www.theiia.org/guidance).

## DISCLAIMER

The IIA publishes this document for informational and educational purposes. This guidance material is not intended to provide definitive answers to specific individual circumstances and as such is only intended to be used as a guide. The IIA recommends that you always seek independent expert advice relating directly to any specific situation. The IIA accepts no responsibility for anyone placing sole reliance on this guidance.

## COPYRIGHT

The copyright of this position paper is held by The IIA. For permission to reproduce, please contact The IIA at [guidance@theiia.org](mailto:guidance@theiia.org).



247 Maitland Avenue  
Altamonte Springs, FL 32701, USA  
Tel: +1-407-937-1100  
Fax: +1-407-937-1101  
Web: [www.theiia.org](http://www.theiia.org)  
E-mail: [guidance@theiia.org](mailto:guidance@theiia.org)