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AUDIT/ENGAGEMENT PROCESS OVERVIEW

BACKGROUND –

The internal audit function provides four major types of engagement services (three of which we subscribe and adhere to GAGAS and IIA standards or disclose nonconformance where applicable) as listed below and explained in the Policies and Procedures (P&P) Introduction section.

- Financial Audits;
- Attestation Engagements;
- Performance Audits; and
- Non-Audit Services/Special Projects/Consulting.

The overall process of performing engagements that culminate in a work product from within the Audit Function is outlined in this Procedure. The AD executes its function to achieve the mission and objectives as specified in the AD Charter. This process is driven by a combination of different, but cooperative inputs and concepts.

Audit is an assurance, assessment, and consulting function that is designed to add value and, as such, operates in reaction to risk. The exercise of due professional care and the consideration of auditing standards require careful consideration and deliberation throughout the performance of audit/engagements (See Policy 130.00 and Procedure 230.00). That being said, audit focus is generally directed at higher levels of residual risk, more sophisticated systems of internal control, intricate operations, and advanced accounting systems (e.g. complex transactions involving regulatory standards, material or significant amount and/or volume).

RELEVANT PROFESSIONAL STANDARDS for service types

These are outlined in	GAGAS 2.02 – 2.13
1. Financial Audits	GAGAS 2.07 – 2.08
2. Attestation Engagements	GAGAS 2.09
3. Performance Audits	GAGAS 2.10 – 2.11
4. Professional Services other than audits (Nonaudit Services)	GAGAS 2.12 – 2.13

The IIA Standards apply to all engagements regardless of service type.

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AUDIT PROCESS PERSPECTIVES

In describing the audit/engagement process, the AD identifies two perspectives as follows:

- **FUNCTIONAL PERSPECTIVE** – driven by Professional Standards and requirements which focus on or emphasize function, activity and outputs;
- **PHASE PERSPECTIVE** – common view with emphasis generally related to a timeline.

Their relationship to each other and reference to the applicable procedure is shown in the following table.

NOTE: Bold and underscored phases indicate the traditional association of the emphasis to the related function.

FUNCTIONAL PERSPECTIVE		AFFECTED PHASE/LEVEL		P&P SECTION	
		ACTIVITY/DOCUMENT	ENGAGEMENT	POLICY	PROCEDURE
Risk & Internal Control	Risk (including Fraud) (ERMA, ERA & ARA)	ERM/ ERA/Audit Universe	<u>Planning</u> /Fieldwork /Reporting	120.00 130.00 190.00	220.30 280.00 290.00
	Internal Control (Entity, Engagement, Process, Activity)	ERM/ERA/Internal Control	<u>Planning</u> /Fieldwork /Reporting	130.00 190.00	220.40 290.00
Planning	Annual	Annual Audit Plan	<u>Planning</u> /Fieldwork /Reporting	120.00	220.10
	Engagement	Engagement Planning Checklist/ Document	<u>Planning</u> /Fieldwork /Reporting	120.00	220.20
Execution	Objectives	Annual Audit Plan	<u>Planning</u> /Fieldwork /Reporting	120.00 130.00	230.00
	Engagement Program & Execution of Audit Procedures	Substantive support	<u>Planning</u> /Fieldwork /Reporting	130.00	230.00
	Scope (Division & Engagement)	Audit Charter/ Annual Audit Plan	<u>Planning</u> /Fieldwork /Reporting	130.00	230.00
	Documentation (Division, Administrative & Engagement)	Quality Control & Assurance	<u>Planning</u> /Fieldwork /Reporting	140.00 170.00	240.00 270.00
	Deliverable	Assurance Services, Cost-Savings & Justification	Planning/Fieldwork /Reporting	150.00	250.00
	Communications (Accountability & Reporting)	ERM/Annual Audit Plan/Quality Control & Assurance	<u>Planning</u> /Fieldwork /Reporting	160.00	260.00

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NOTE: The focus of this document is primarily at the Engagement level (with the exception of the Annual Audit Plan as it defines the engagements to be performed for the upcoming year).

FUNCTIONAL PERSPECTIVE

The primary components (functional elements) of executing or performing most engagements (other than special projects or consulting activities) are as follows:

- Planning (Annual Audit Plan and Audit/Engagement Planning);
- Risk and related Assessment (Enterprise, Engagement/Process);
- Internal Control and related Assessment;
- Objectives;
- Engagement Program (specific procedures);
- Scope;
- Documentation;
- Engagement Deliverable; and
- Communications.

THE (ANNUAL AUDIT) PLAN

(SEE [PROCEDURE 220.10](#))

The Plan (Annual Audit) is a list of audits/engagements or projects for the upcoming fiscal year prepared by the AD and approved by the CC. The Plan results from consideration of the following:

- Risk-based methodology and an ongoing process of assessment of the City's risk management and related control structure;
- Previous audits, findings, conclusions, and recommendations; and
- Input from Elected Officials, AD Staff, and other stakeholders.

AUDIT/ENGAGEMENT PLANNING

(SEE [PROCEDURE 220.20](#))

It is critical to note that the Engagement Planning process is interactive and dynamic, rather than linear or sequential. Per GAGAS 6.07, "...*Planning is a continuous process throughout the audit. Therefore, auditors may need to adjust the audit objectives, scope, and methodology as work is being completed.*" It is commonly modified throughout the project as information and results are obtained, assessed, and conclusions are rendered. Auditor judgment and engagement team communication are critical elements in the overall project. For instance, information gathered may expand the scope, which will affect the program, procedures, and resources (budget), or it may be decided to refine the scope and address additional items under a separate project or follow-up.

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As indicated in Policy 120.00 and Procedure 220.20: “Information accumulated as a result of engagement planning will contribute to the following:

- Identification of the Overall Engagement Objective;
- Identification and refinement of Scope;
- Internal Control Assessment;
- Defining Risk and its Residual;
- Setting Specific Audit Objectives;
- Developing the Audit Program; and
- Determining resources needed to accomplish the Overall Engagement and Specific Audit Objectives (this includes the Engagement Budget)”.

Audit/engagement planning is a process that is included in the electronic workpapers as required engagement documentation. A checklist is used as guidance for essential elements of the planning process having been performed with reference to supporting documentation.

RISK MANAGEMENT AND RISK ASSESSMENT

(SEE [PROCEDURE 220.30](#) AND [RELATED DIAGRAM](#))

Risk is the primary driver that influences management focus for resolution and resource allocation. Identification of risk begins at the entity-wide level and is performed as an ERA, which includes an Assessment of the ERM Processes. This examination begins with the mission, goals, and objectives of the City and each of the Departments. The goals and strategy for achievement are a significant factor in identifying risk. More aggressive goals yield higher risk, with the expectation of higher returns (financial and non-financial). It’s important to note that high or low risk is not judged as good or bad, but rather implies the necessary control environment and its level of sophistication required to sufficiently mitigate that level of risk to a satisfactory residual.

Risk assessment takes place on two primary levels (enterprise and audit/engagement levels), containing three different views:

- An ERA, which includes an Assessment of ERM, interacts with the Audit Universe, and provides input to creating the Annual Audit Plan;
- An Assessment of relevant risks associated with the particular Program/Process/Function which is the focus of the engagement (ARA); and
- An Assessment of the Risk of Incorrect Audit Conclusions (Audit Risk – AR).

The last two are the key risk focuses at the engagement level. The ERA considers the control structure put in place by management as a reaction to risks while the AR takes all these factors into account in identifying the risk of incorrect conclusion(s). As a result, the nature, extent, and timing of testing are the AD’s response to the estimated risk in attempting to bring the residual to an acceptable level.

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ARA is supported by documented evidence and included in the workpapers, as required in Procedure 240.00

INTERNAL CONTROL STRUCTURE & ASSESSMENT (IC AND ICA)

(SEE [PROCEDURE 220.40](#) AND [RELATED DIAGRAM](#))

Because IC is interrelated with risk, it also resides at the enterprise and audit/engagement levels and can be assessed from three perspectives:

- As a key element to the ERA and the Assessment of ERM, IC provides a basis to evaluate the residual risks and impacts the ranking of auditable components for prioritization in audit planning;
- As a separate audit on an entity/department, component, function or process (ARA); and
- As a key element to the ARA related to the component, function, or process it provides a basis for a level of reliance in determining the nature, timing, and extent of further testing.

Developing, implementing, and maintaining a system of IC is management's reaction to its perceived risk, its tolerance for risk, and its available resources to address risk. The AD performs an assessment of the control structure by applying the COSO framework to gain an understanding of the five following components:

- Control Environment;
- Risk;
- Internal Controls;
- Information and Communication; and
- Monitoring.

Process documentation is created and/or reviewed, and is used to identify and assess the adequacy of the design and effectiveness of the implementation of control points. The assessment is supported by workpapers that become part of the Engagement Documentation.

OBJECTIVES

(SEE [PROCEDURE 230.00](#))

Objectives are set and refined as necessary within four strata:

- The Mission Statement as outlined in the AD Charter and as defined by the IIA;
- Engagement Objectives as identified in the Annual Audit Plan;
- Engagement specific objectives as refined and identified in the results of the ARA and ICA (if applicable); and
- Objectives that create the need for specific procedures as outlined in the Engagement Program.

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Objectives interact and correlate with the procedures (Audit/Engagement Program) and Scope. They are communicated to responsible management through the Engagement Letter and are documented in the Annual Audit Plan.

They are also included in the workpapers as Engagement Documentation:

- On a macro level for the project as a whole;
- Further refined as a result of the ARA; and
- At the procedural level associated with a step from the Audit/Engagement Program.

SCOPE

(SEE [PROCEDURE 230.00](#))

Per [GAGAS 6.09](#), Audit Scope is: *“the boundary of the audit and is directly tied to the audit objectives. The scope defines the subject matter that the auditors will assess and report on, such as a particular program or aspect of a program, the necessary documents or records, the period of time reviewed, and the locations that will be included.”*

Scope is identified on three levels:

- Scope of Work as identified in the AD Charter;
- Engagement Scope (related to the engagement objectives); and
- Procedural Scope (related to workpapers generated as a result of a specific engagement/audit procedure).

Further, the audit/engagement scope is interrelated with the objectives and procedures and is documented and communicated in the Engagement Letter, the final deliverable, and workpapers (as part of the project definition and procedure attachment and Engagement Documentation).

AUDIT/ENGAGEMENT PROGRAM (THE PROGRAM)

(SEE [PROCEDURE 230.00](#))

The Program is a series of specific procedures that are designed to meet audit/engagement objectives and reduce Audit/Engagement Risk to an acceptable level. The Program focuses on analyzing and evaluating information to adequately support the resulting findings, conclusions, recommendations and commendations with sufficient and appropriate evidence. As a set of defined procedures, the Program is important to, and interrelated with, the stated scope and objectives. The Program can include activities such as; performing interviews, creating diagrams and flowcharts, reviewing documentation (industry, and client specific), identifying and testing controls, performing a risk assessment, and detail tests of account balances and transactions. It also involves, in part, obtaining and reviewing reports, account reconciliations, vendor invoices, payments, etc. The supporting information for audit procedures is part of the required Audit/Engagement Documentation and drives other recorded evidentiary support.



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AUDIT/ENGAGEMENT DOCUMENTATION

(SEE [PROCEDURE 240.00](#))

In order to serve as a basis for results, documenting is a process by which evidence is gathered, analyzed, evaluated, systematically organized, and retained in a form referred to as Audit/Engagement Documentation.

Audit/Engagement Documentation serves as a basis for:

- Sufficient and appropriate evidence to support findings, conclusions and recommendations;
- Supervisory review for proficiency and competence, and the exercise of due professional care; and
- Quality review.

Per GAGAS 6.79, *“Auditors must prepare audit documentation related to planning, conducting and reporting for each audit. Auditors should prepare audit documentation in sufficient detail to enable an experienced auditor, having no previous connection to the audit, to understand from the audit documentation, the nature, timing, extent, and results of audit procedures performed, the audit evidence obtained and its source and the conclusions reached, including evidence that supports the auditors’ significant judgments and conclusions.”*

AUDIT/ENGAGEMENT DELIVERABLE

(E.G. AUDIT REPORT)

(SEE [PROCEDURE 250.00](#))

The Audit/Engagement Deliverable is typically expressed in the form of a report. The report is drafted throughout the engagement, using a format/layout as prescribed by the AD. As issues or findings are identified and verified, they may become incorporated into the Report in detail or summary format, depending upon their overall impact, including likelihood of occurrence.

The final version of the report is issued with a transmittal letter from the CC that identifies the entity, function, transaction cycle, or process (es) which were the focus of the audit/engagement. The transmittal letter is signed by the CC, while the attached report is signed by the City Auditor, Manager, and the Lead Auditor assigned to the audit/engagement. An executive summary highlights the key points identified through the course of performing the audit/engagement procedures and presents them concisely for executive management’s review. The detail section of the report provides supporting information for further analysis and explanation, with references where applicable.

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COMMUNICATIONS

(SEE [PROCEDURE 260.00](#))

Communications are an essential component and function of the AD and are reflected primarily in the following elements:

- Proposed and approved Annual Audit Plan between the AD, City Controller, City Council and Citizens;
- Status of projects, changes to the plan/budget and limitations to Scope of Work based on resources;
- Notification of audit/engagement scope, objectives, and methodology to the responsible management (including boundaries of responsibilities for Non-Audit Services);
- Requests and monitoring of information, verification, responses to: specific issues and/or findings throughout the engagement and to the Audit/Engagement Deliverable;
- Dissemination of results, including findings, conclusions, commendations, and recommendations, and management responses; and
- Relevant disclosures of fraud, illegal activity and/or impairments to independence.

RELEVANT PROFESSIONAL STANDARDS AND GUIDANCE

GAGAS

GENERAL STANDARDS	CHAPTER 3
FINANCIAL AUDITS	4.01 – 4.09, 4.15 – 4.27, 4.28 – 4.45
ATTESTATION ENGAGEMENTS	5.03 – 5.10, 5.16 – 5.26, 5.27 – 5.44
PERFORMANCE AUDITS	6.06 – 6.51
	Chapter 7

IIA STANDARDS

- 1000 – PURPOSE, AUTHORITY
 - 1000.A1
 - 1000.C1
- 1010 – RECOGNITION OF THE DEFINITION OF INTERNAL AUDITING, THE CODE OF ETHICS, AND THE STANDARDS IN THE INTERNAL AUDIT CHARTER
- 1110 – ORGANIZATIONAL INDEPENDENCE
 - 1110.A1
- 1111 - Direct Interaction with the Board (MANAGEMENT)
- 1220 - DUE PROFESSIONAL CARE
- 1320 - REPORTING ON THE QUALITY ASSURANCE AND IMPROVEMENT PROGRAM
- 2000 – MANAGING THE INTERNAL AUDIT ACTIVITY
 - 2010 - PLANNING
 - 2020 - COMMUNICATION AND APPROVAL
 - 2030 - RESOURCE MANAGEMENT
 - 2050 - COORDINATION
 - 2060 - REPORTING TO THE BOARD AND SENIOR MANAGEMENT

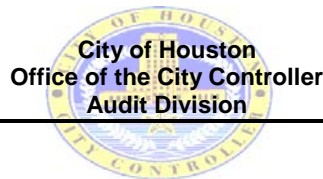

City of Houston
Office of the City Controller
Audit Division

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- 2100 - NATURE OF WORK
- 2110 - GOVERNANCE
- 2120 - RISK MANAGEMENT
- 2130 - CONTROL
- 2200 - ENGAGEMENT PLANNING
- 2201 - PLANNING CONSIDERATIONS
- 2210 - ENGAGEMENT OBJECTIVES
- 2220 - ENGAGEMENT SCOPE
- 2230 - ENGAGEMENT RESOURCE ALLOCATION
- 2240 - ENGAGEMENT WORK PROGRAM
- 2300 - PERFORMING THE ENGAGEMENT
- 2310 - IDENTIFYING INFORMATION
- 2320 - ANALYSIS AND EVALUATION
- 2340 - ENGAGEMENT SUPERVISION
- 2400 - COMMUNICATING RESULTS
- 2410 - CRITERIA FOR COMMUNICATING
 - 2410.A1
 - 2410.A2
 - 2410.A3
 - 2410.C1
- 2420 - QUALITY OF COMMUNICATIONS
- 2421 - ERRORS AND OMISSIONS
- 2430 - USE OF "CONDUCTED IN CONFORMANCE WITH THE INTERNATIONAL STANDARDS FOR THE PROFESSIONAL PRACTICE OF INTERNAL AUDITING"
- 2431 - ENGAGEMENT DISCLOSURE OF NONCONFORMANCE
- 2440 - DISSEMINATING RESULTS
 - 2440.A1
 - 2440.A2
 - 2440.C1
 - 2440.C2
- 2500 - MONITORING PROGRESS
- 2600 – RESOLUTION OF SENIOR MANAGEMENT’S ACCEPTANCE OF RISKS

IIA PRACTICE ADVISORIES

- 1000-1 Internal Audit Charter
- 1110-1 Organizational Independence
- 1111-1 Board Interaction
- 1120-1 Individual Objectivity
- 1130-1 Impairment to Independence or Objectivity
- 1130.A1-1 Assessing Operations for Which Internal Auditors Were Previously Responsible
- 1130.A2-1 Internal Audit’s Responsibility for Other (Non-audit) Functions
- 1200-1 Proficiency and Due Professional Care
- 1210-1 Proficiency
- 1210.A1-1 Obtaining External Service Providers to Support or Complement the Internal Audit Activity
- 1220-1 Due Professional Care
- 1230-1 Continuing Professional Development
- 1300-1 Quality Assurance and Improvement Program
- 1310-1 Requirements of the Quality Assurance and Improvement Program
- 1311-1 Internal Assessments
- 1312-1 External Assessments



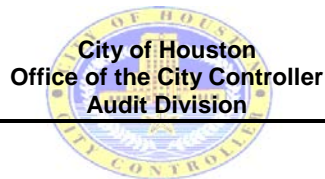
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- 1312-2 External Assessments: Self Assessment with Independent Validation
- 1312-3 Independence of External Assessment Team in the Private Sector
- 1312-4 Independence of the External Assessment Team in the Public Sector
- 1321-1 Use of "Conforms with the International Standards for the Professional Practice of Internal Auditing"
- 2010-1 Linking the Audit Plan to Risk and Exposures
- 2010-2 Using the Risk Management Process in Internal Audit Planning
- 2020-1 Communication and Approval
- 2030-1 Resource Management
- 2040-1 Policies and Procedures
- 2050-1 Coordination
- 2050-2 Assurance Maps
- 2050-3 Relying on the Work of Other Assurance Providers
- 2060-1 Reporting to Senior Management and the Board
- 2110-1 Governance: Definition
- 2110-2 Governance: Relationship With Risk and Control
- 2110-3 Governance: Assessments
- 2120-1 Assessing the Adequacy of Risk Management Processes
- 2120-2 Managing the Risk of the Internal Audit Activity
- 2130-1 Assessing the Adequacy of Control Processes
- 2130.A1-1 Information Reliability and Integrity
- 2130.A1-2 Evaluating an Organization's Privacy Framework

- 2200-1 Engagement Planning

- 2200-2 Using a Top-down, Risk-based Approach to Identify the Controls to be Assessed in an Internal Audit Engagement
- 2210-1 Engagement Objectives
- 2210.A1-1 Risk Assessment in Engagement Planning
- 2230-1 Engagement Resource Allocation
- 2240-1 Engagement Work Program
- 2300-1 Use of Personal Information in Conducting Engagements
- 2320-1 Analytical Procedures
- 2320-2 Root Cause Analysis
- 2330-1 Documenting Information
- 2330.A1-1 Control of Engagement Records
- 2330.A1-2 Granting Access to Engagement Records
- 2330.A2-1 Retention of Records
- 2340-1 Engagement Supervision
- 2400-1 Legal Considerations in Communicating Results
- 2410-1 Communication Criteria
- 2420-1 Quality of Communications
- 2440.A2-1 Communications Outside the Organization
- 2440-1 Disseminating Results
- 2440-2 Communicating Sensitive Information Within and Outside the Chain of Command
- 2500-1 Monitoring Progress
- 2500.A1-1 Follow-up Process

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PHASE PERSPECTIVE

It is common practice to refer to an engagement in phases, usually thought of in relationship to a timeline. Most often, the primary phases are as follows:

PLANNING AND PRELIMINARY SURVEY

This has been traditionally thought of as foundational work performed in the office, prior to beginning other procedural work at the client location(s). From this perspective, planning and preliminary survey generally includes, but is not limited to, reviewing previous audit/engagement workpapers, findings and conclusions, obtaining an understanding on process/entity to be audited, outlining the objectives, scope and preparing the audit/engagement program, assigning staff, sending the engagement letter and initial request for information.

FIELDWORK

Fieldwork, as a phase is usually thought of in relation to the time spent 'in the field' or at the client/auditee location. The length of fieldwork varies based on the scope, objectives, audit/engagement program and procedures. Fieldwork may be modified based upon information, analysis, and any significant event that transpires and impacts the specific audit/engagement objectives, execution of the specific audit procedures and/or overall audit/engagement objectives.

In general, fieldwork involves gathering evidence, (e.g. performing tests, data analysis, interviews, etc.) evaluating the results, and formulating conclusions. The product of this phase is reflected in the audit/engagement workpapers, which document the purpose, scope, source (sample), objectives and conclusions of the audit procedures performed. Sufficient and appropriate evidence is required to support conclusions.

Per GAGAS, sufficient evidence is a quantitative element, while appropriate evidence is reflected as a qualitative measure. Exceptions are noted during this phase and may result in formal findings, with facts presented to and confirmed by the auditee/client. This information is entered into the workpaper software and classified appropriately. Auditor judgment is a critical part of this phase, in addition to a heightened awareness and attention to detail, while maintaining focus on the larger objectives. As information is received (or not), modifications may be made to the audit/engagement program, budget and/or scope to adapt accordingly. These variables interact and are balanced with resources and objectives to optimize Audit Efficiency and Effectiveness.

REPORTING/WRAP-UP

As a phase, this is generally thought to begin after the last date in the field and involves the formal documentation, presentation, modification, and issuance of the final audit/engagement deliverable (commonly distributed as a report) and the parallel review process taking place on both the report and the underlying audit/engagement documentation. Communication with auditee/client management which includes: verification, revision, and obtaining and assessing their responses is part of activities performed by the AD in this phase.

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RELEVANT PROFESSIONAL STANDARDS AND GUIDANCE

GAGAS

CHAPTERS 1-3

IIA PRACTICE ADVISORIES

- 1000-1 INTERNAL AUDIT CHARTER
- 2330.A1-2 GRANTING ACCESS TO ENGAGEMENT RECORDS
- 2500.A1-1 FOLLOW-UP PROCESS

CHANGE HISTORY

Chg #	Date	Section	Description/Reason
1	3/31/2016	All	General edits