



## A Few Good Words—Writing Report Opinions

By Sally F. Cutler

Until now, your reports have been issued without a formal “opinion.” You’ve taken this approach because you believe it enables you to more effectively persuade management to take action. But now your audit committee wants you to include a formal opinion—and an overall rating—on every report. You’re wondering how you can meet the audit committee’s need without alienating your audit customers, with whom you have steadily been building a trusting and productive relationship.

This column will define whole-report opinions and will explore why and how internal auditors write them. Included will be the pros and cons of rating systems: their value for audit committees and executives as well as their potential to create conflicts with management. Finally, the column will address multi-report opinions—an increasingly frequent audit-committee request. The column will place these ideas in the context of recent guidance on opinion writing.

### Whole-Report (Micro) “Opinions”

Whole-report opinions are high-level conclusions about the overall import of the observations within a single report. They may be called “micro” opinions to distinguish them from opinions that span multiple reports, which may be called “macro” opinions.

The guidance provided by The Institute of Internal Auditors says that whole-report opinions are “evaluations of the effects of observations and recommendations” and that they “put the observations and recommendations in perspective based on their overall implications.” This language points to a crucial aspect of a whole-

report opinion, namely, that it is more than a summary. Consider this example:

You audited procurement, and one aspect you looked at was background checks on contract personnel, including those providing patient services. You have a spreadsheet with data for a sample of 25 such active contract personnel. The spreadsheet documents whether a background check was conducted for each contractor and whether all components of the background check were completed. The spreadsheet shows that background checks were not conducted for Contractors A and B; it also shows that drug testing—a required aspect of the background check—was pending for Contractors C, D, and E. All five of these contractors were providing services.

One possible summary of this detail is, “We sampled 25 active contract personnel providing patient services and found 5 for whom required background checks either were not conducted or were incomplete.”

However, a conclusion about the findings goes further. For example, a conclusion might say, “Patients may have been put at risk because background checks on some contract personnel providing patient services either were not performed or were incomplete.” Moreover, if supported by interviews and observations, your conclusion might go on to say something like, “Deficiencies in performing background checks resulted from a lack of centrally assigned responsibility for this activity, with departments interpreting the requirements in differing ways.”

Conclusions, then, are broader statements—founded on facts—that rise to the level of describing the effects (risks) and causes of the conditions you found.

A whole-report conclusion—an opinion—describes the themes or commonalities across an entire report. Thus, an opinion focuses on higher-level and often systemic issues revealed by the audit. An opinion reaches to the level of providing



a consolidated view of the “overall implications” of the findings.

For example, say that your audit of procurement found not only differing interpretations related to background checks but also conflicting interpretations of other procurement requirements. Your overall conclusion could be that the organization risked patient safety and operating effectiveness by using inappropriate vendors in essential and non-essential areas because procurement management was not coordinating procurement activities (a control-environment issue) and was not communicating effectively with management in other areas of the organization.

## Rating System Pros and Cons

### Positive Impacts of Ratings

When used, a whole-report rating system is part of the auditor’s opinion. It consolidates the opinion into an easy-to-grasp phrase, numeric value, or color. Thus, audit committees and executive readers favor rating systems, and the reasons are easy to see:

- A rating system provides an instant view of the auditor’s opinion.
- The rating provides context for everything else in the report, both in terms of significance and urgency.
- Reports can be more easily compared, as can audit results for units across the organization.
- Ratings help management set priorities.

### Common and Not-so-Common Rating Systems

Most such systems use three ratings. They may be given descriptors, most often *unsatisfactory*, *needs improvement*, and *satisfactory*. Alternatively, they may be numbered or assigned colors (the “traffic light” colors of *red*, *yellow*, and *green*). This three-point system is straightforward and communicates a simple range within the opinion.

Organizations aiming for more clarity in the middle category of a three-point system may split the *needs improvement* rating. The new descriptors may be *needs significant improvement* and *needs improvement*, or they may be *mostly*

*unsatisfactory* and *mostly satisfactory*. A color-based system may add *orange* between *yellow* and *red*.

Some innovative organizations have enhanced their report ratings by displaying other dimensions along with the report rating. They do so to provide the audit committee and senior executives with a comprehensive view of the control environment. One such organization provides these three dimensions:

- Inherent risk (*high, medium, low*). This is the risk that placed the audit on the audit plan in the first place.
- Residual risk, which is the actual report rating (*unsatisfactory, needs improvement, satisfactory*). This rating is based on the issues found during the audit.
- Management awareness (*high, medium, low*). This rating is based on management’s self-identification of issues—and resulting actions—before the audit began as well as on whether issues in the report are repeat issues.

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Whatever the rating system, you’ll be wise to periodically check that the ratings continue to function in communicating relative concern. Thus, unless an organization is exceptional, we would expect a distribution of ratings—albeit neither an even distribution nor a bell-shaped curve. A rating system needs revision if, for example, all or almost all reports receive a *needs improvement* rating; never or rarely is an *unsatisfactory* or *satisfactory* rating issued.

### Formulation of the Rating

A whole-report rating is arrived at by tempering objective criteria with professional judgment.

Objective criteria may include any or all of the following:

- The number of high-priority observations in the report
- The nature and extent of the risks (for example, pervasive health-and-safety issues weighing more heavily than sporadic accounting errors)
- The nature and extent of the causes (for example, findings resulting from intentional bypasses weighing more heavily than those resulting from staff making one-off errors)
- Whether issues found are repeat issues from previous audits

Once ratings criteria are established, however, auditors must add perspective and be willing to use judgment in making the final rating decision. Important factors include the auditor’s perception of management responsiveness and the compounding of risks across observations.

### Negative Impacts of Ratings

Audit committees and executives favor ratings, but management often does not. The very clarity that makes ratings attractive to audit committees and executives makes ratings unattractive to our management audit customers. They may feel that ratings oversimplify complex issues, are unfairly judgmental, or suppress audit-customer efforts to rectify problems.

The tensions over ratings can impact the auditor’s relationship with the audit customer. We auditors claim to be helping management achieve better governance, risk management, and controls, but then we apply a rating—a grade—to management’s efforts. The rating may feel to management like punishment.

Furthermore, some auditors find that management is fixated on improving the report rating, taking the focus off the issues themselves. In some organizations, the negotiation of the rating obstructs report issuance; in others, where ratings have consequences for job security and careers, escalations and delays can be common.

Furthermore, many auditors must interact with audit customers on repeated engagements, and relationships can be poisoned by protracted ratings battles. Auditors focused on adding value

through management action may question how ratings move the organization in a productive direction.

### *To Rate or Not To Rate*

In deciding whether or not to rate your reports, you should weigh a number of factors:

- Your organization
  - What is your organization's culture? Other areas of your organization may commonly rate activities and outcomes; if so, internal audit will better align with the organization by adopting ratings.
  - How large is your organization? The more lines of business, operating units, and geographies within your organization, the more useful ratings are.
  - How much change is your organization undergoing? The more your organization is changing, the more useful ratings are.

- Your audit function
  - How many audits do you conduct? The more audits you conduct, the more useful ratings are.
  - How responsive is management in closing issues? Ratings are useful in helping management see the priority of closure.

### **Multi-Report (Macro) "Opinions"**

The convergence of financial and operational pressures on organizations has increased interest in internal audit offering multi-report (macro) "Opinions." Internal audit functions have long summarized results for their audit committees; recently, however, audit committees have sought an overall opinion from internal audit (as they do from external financial auditors). Internal audit is being asked to express an overall (macro) opinion on governance, risk management, internal controls, the control environment, compliance, and so forth.

- Whether the audit work and audit evidence are sufficient to support a macro opinion
- The criteria on which the macro opinion is based
- The organization's risk appetite related to the criteria
- Clear definitions of the terms used to express the macro opinion

### **Clarity through Opinions**

After discussions with the audit committee and executive management, you reach a consensus on whole-report opinions, including a rating system. All stakeholders—audit committee, executive management, and management—are clear about how internal audit will develop the opinion and the rating and how these components will be used by management and the audit committee. You are committed to using this approach to deliver crisper messages to all of these stakeholders. And although your audit committee is not yet asking for a "macro" opinion, you are confident that, if and when they do, you will be able to develop a firm foundation for communicating at that level as well. **NP**

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*Audit committees and executives favor ratings, but management often does not.*

- Your audit committee
  - Does your audit committee see all of the audit reports, some of them, or multi-report summaries only? Ratings are particularly useful in developing multi-report summaries.
  - How engaged is your audit committee? Ratings can grab the attention of a disengaged audit committee.

Your decision to provide such an opinion should be based on considerations of intent, audit coverage, and clarity. Recent guidance from The Institute of Internal Auditors provides an in-depth discussion of such considerations. In brief, these considerations include the following:

- The purpose of the macro opinion
- Whether the audit period and testing timelines support a macro opinion

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*I do not try to dance better than anyone else. I only try to dance better than myself.*  
~Mikhail Baryshnikov

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