



# Achieving High Performance in Internal Audit

*Sixth Edition - Insights from Audit Committee Chairs and Members*

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## Executive Summary

Welcome to the 2014 Internal Audit Benchmarking Study. For the past six years, the Institute of Internal Auditors – Australia (IIA-Australia) and Protiviti have conducted comprehensive surveys of the internal audit profession to identify trends and developments.

In 2014, our research continues to explore the fundamental themes of internal audit independence, value and service quality. The 2014 study is based on the combined results of a quantitative survey of approximately 70 Audit Committee Members, with the added depth of qualitative feedback gained through holding separate roundtable discussions with select Audit Committee Chairs (Audit Chairs). Audit Chairs and Committee Members participating in the research were from leading organisations in the listed, private and federal government sectors. The organisations represented engaged a mix of in-house, co-sourced and outsourced internal audit teams.

An important theme emerging from this year's research is that while internal audit has a seat at the Audit Committee table, it does not currently have a monopoly on assurance and is not necessarily the Audit Chair's primary source of insight on all risk and assurance matters. To be considered the peak assurance provider and to maintain its seat at the table, internal audit must address particular skills gaps and assert greater leadership in:

- Aligning their work to emerging risks;
- Contributing value-add through commercial acumen and relevance,
- More timely and comprehensive insights through data analytics; and
- Providing a comprehensive picture of the organisation as a whole through assurance mapping.

Data analytics and assurance mapping were two key areas in which internal audit needs to quickly gain proficiency or risk other functions seizing these opportunities and diminishing internal audit's role.

Another strong theme is that while Audit Chairs are adamant internal audit has a role in the C-Suite, many internal auditors were perceived to still lack some of the sophisticated commercial skills to gain and maintain the respect of the leadership team.

We trust this report will be a useful resource for internal audit practitioners to support their ongoing professional development.

## Reliance on internal audit

The quantitative survey revealed that Audit Committee Members place a high level of reliance on assurance provided by internal audit in the top three areas of Operational Risks, Risk Management and Financial Reporting Controls. The areas where internal audit are least relied upon are Project Assurance and Bribery & Corruption.

The findings suggest that organisations with a mature internal audit function tend to value internal audit's contribution to assurance over a wide range of issues. However, it is also clear that internal audit does not have a monopoly over the full suite of assurance needs and that Audit Committees will in fact seek assurance from a variety of other sources including risk officers, management and external auditors. Audit Chairs also indicated that they expect internal audit to understand and take account of assurance from other parties.

Audit Chairs participating in the roundtables confirmed that they always use 'the best assurance provider for the job' and that the best expert is not always internal audit.

For example, internal audit is often not perceived to have the capability to provide assurance over specialised risks such as treasury, IT, workplace safety or derivatives. Views on internal audit's role in project assurance are also mixed. One roundtable participant did not rely on internal audit at all as it was more effective to establish a direct reporting relationship between the project manager and Audit Committee given the need for frequent, regular reporting. Another participant said the Chief Audit Executive (CAE) would generally be on the project steering group but the executive in charge of the project also reported directly to the Audit Committee.

With regard to risk management, some Audit Chairs said the Chief Risk Officer (CRO) is their primary source of information to gain a complete picture of the organisation's overall risks. Internal audit serves more as a sounding board and counterpoint to validate the CRO's views.

The discussion on strategic risk has progressed since the 2012 survey. All roundtable participants indicated that they did not consider internal audit to be the 'doyen' or primary authority on strategic risk. That is, while they did not expect internal audit to lead the process of identifying and managing strategic risks, they do expect it to be actively involved with the executive group that makes strategic decisions and to participate in relevant scenario planning. They suggested that stronger commercial skills were central to gaining recognition in this area.

Audit Chairs emphasised the importance of internal audit's 'surveillance' role. It was critical for internal audit to survey changes within the organisation and its environment, identify and understand their impacts on the business and work co-operatively with colleagues to identify and address emerging risks.

In a changing environment, Audit Chairs were adamant that audit plans must be flexible enough to incorporate emerging risks and issues as they arose. One Chair said they would have concerns about the effectiveness of the internal audit function if audit plans were not recalibrated during the year to accommodate ongoing changes.

In summary, Audit Chairs continue to see internal audit as a vital contributor to the Audit Committee's effectiveness, but do not currently see it in the 'peak' assurance role. In fact, they will consult with whomever they see as the 'best expert' on a particular risk. Internal auditors therefore cannot be complacent about the scope of their risk assurance role and should strive to build their capabilities, particularly in assurance mapping and in responding to emerging risks, and to deliver outcomes that are valued by Audit Chairs and the organisation.



Successful internal auditors must have the hard edge of technical audit skills and the commercial acumen to garner the respect of the leadership team because they have something important to contribute.”

## Authority and independence

Over the years, there has been steady improvement in the independence of the internal audit function from undue management influence. According to the 2014 survey, the CAEs in 90 per cent of the organisations surveyed now meet privately either with the Audit Chair, the Audit Committee or both, without management present. It is a welcome development that direct reporting lines to the Audit Chair or Committee have become the norm for the profession.

The survey reported that 62 per cent of respondents held private meetings with the Audit Chair or Committee periodically during the year, while 13 per cent held them annually and 15 per cent, as required. These meetings are a forum for CAEs to demonstrate the value and relevance of internal audit. One roundtable participant noted that CAEs should seize these opportunities to develop strong professional relationships with the Audit Chair based on trust, so that internal audit has a champion in the event that difficulties arise with management.

The International Standards for the Professional Practice of Internal Auditing (the 'Standards') require organisations to perform an External Quality Assessment (EQA) of the internal audit function at least every 5 years. In line with this requirement, the majority of survey respondents said their organisation had performed an EQA either within the last 12 months (24 per cent) or between one and five years ago (42 per cent). The five year interval was seen as too long by some Chairs, with 3-4 years being a more reasonable timeframe. Chairs indicated they expect proactive internal audit functions to initiate these reviews and not wait for a request from the Committee.

One Audit Chair found that an EQA performed shortly after they assumed the Audit Chair role, provided a very useful picture of the capabilities, independence and resourcing needs of the firm's internal audit team. There is therefore scope for EQA demand to be driven by Audit Chairs, even though the majority are currently initiated by CAEs. Another Audit Chair noted that

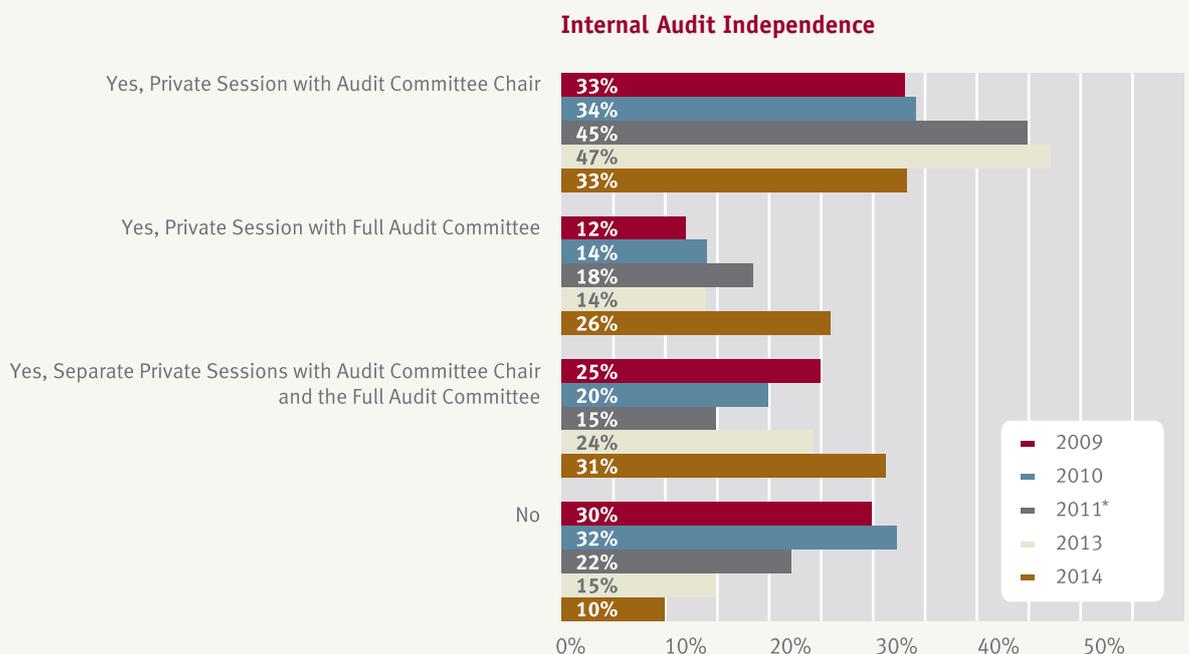
EQAs should not focus purely on procedural issues such as technical compliance with the Standards but were only valuable if they also tested performance and outcomes - that is, whether internal audit was focussed on the right issues and delivering meaningful results.

## Trends and value

The 2014 Survey reported that the top five priorities for internal audit were: IT (72 per cent), Core financial controls (68 per cent), Risk management attestation (55 per cent), Fraud (50 per cent) and Major project implementations (40 per cent). While many organisations have core risks in common, an organisation's risk priorities can vary widely from industry to industry.

As in previous years, management and the Audit Committee continue to differ over the value of internal audit. 75 per cent of respondents said the Audit Committee found internal audit provided significant value. In contrast, only 54 per cent said management found internal audit provided significant value. Clearly there is room for internal audit to close the value perception gap between the Audit Committee which is very committed to internal audit and management which continues to question its benefits.

All roundtable participants agreed that to garner greater respect from management and consolidate influence with Audit Chairs, internal audit must balance being a purely backward-looking compliance function with providing more commercial and proactive advice to assist the business with new projects, ventures, product launches and the like. However, while Audit Chairs cautioned that a more commercial focus was essential to elevate internal audit to the C-Suite, this should not occur at the expense of the role's day-to-day compliance and control



\*Please note, the 2012 survey was qualitative research and not relative to these graphs.



responsibilities. This remains a delicate balance and one that should be reconfirmed periodically with each Audit Committee.

When asked to describe internal audit's single most valuable contribution in the past 12 months, survey responses varied widely but reflected four main themes. Internal audit:

- Provided assurance where it mattered
- Helped the Audit Committee better understand the organisation's risk environment
- Improved risk management and controls in the organisation
- Improved the user experience of internal audit (primarily through better reporting).

The diverse issues nominated may suggest that the internal audit function at the organisations surveyed are at different stages of maturity and that Audit Chairs are receiving an inconsistent experience from their internal audit functions.

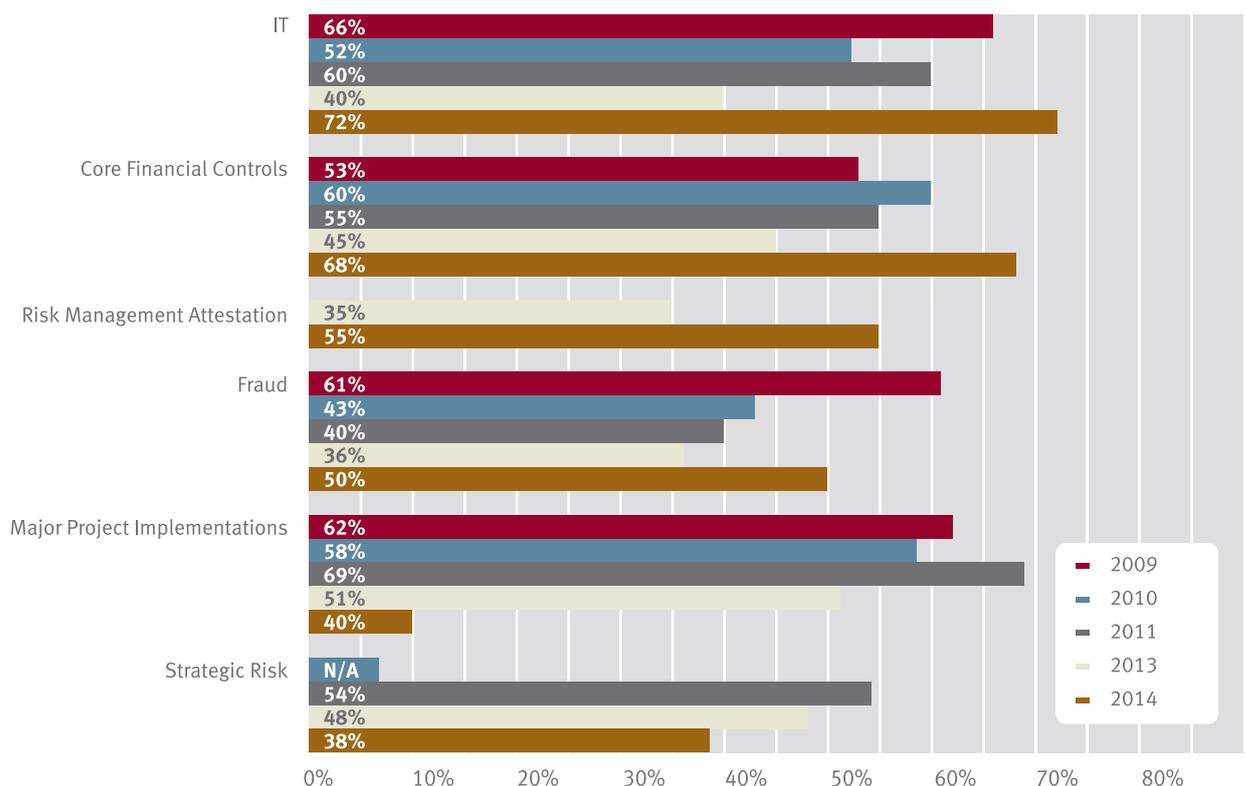
## Internal audit reporting

The 2014 Survey indicated that respondents considered the following five content areas to be very important for internal audit reports to the Audit Committee:

- Recommendations
- Conclusions
- Solutions developed jointly with management
- Risk ratings
- Themes and trends

When asked about the quality of the content in internal audit reports compared to other reports to the Audit Committee, respondents were most impressed with the following five content areas, (with 64 per cent rating them as of either above average or exceptional quality): Report ratings, Risk ratings, Recommendations, Conclusions and Prioritisation. The four content areas requiring greatest improvement were: Themes & trends, Point of view, Dashboards and Page-at-a-glance summaries.

### Internal Audit Priorities



The survey reported that currently, the majority of Audit Committees do not require internal audit to provide an 'overall opinion' on the organisation's controls as a whole. Only 38 per cent request such opinions. However the trend is gaining momentum and should improve if internal audit asserts itself in the area of assurance mapping and emerging risks.

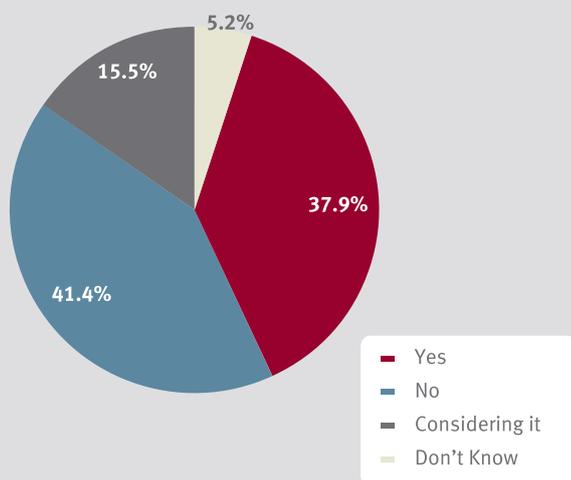
One prominent listed company director said, "The board expects the Audit Committee to give them a view of the control environment in specific areas as well as on the organisation as a whole. It's only reasonable to expect the same from our CRO, management and internal auditors".

Roundtable participants emphasised that reports should always be written and structured with the needs of the Audit Committee in focus. To this end, reports should be concise and always include a summary of critical issues and outcomes. They should prioritise significant issues requiring board consideration rather than indiscriminately cover low-level matters. Audit Chairs also wanted to see quality recommendations developed with the buy-in of management.

Chairs explained that 'ideal' board papers would include a summary page for every agenda item capturing key findings and actions on all significant issues. Details relating to those issues would sit behind the summary. An appendix might also be included, covering lower-priority issues which are a 'nice-to-read' but not critical. Agenda items should be allocated timings and specify what actions the CAE wants from the board. For example, is the issue simply to be 'noted', or is it 'for discussion' or 'approval' by the board.

These findings indicate that while internal audit reports are generally adequate, there is still a strong need to close the gap between Audit Committee expectations and the current state of report quality. Recognising that needs change over time and by subject matter, this should be a matter of ongoing dialogue between the CAE and Audit Chair.

**Is internal audit asked to provide an 'overall opinion' on the organisation's controls as a whole**



## Capability of internal audit function

The 2014 Survey revealed that the capabilities most commonly considered 'very important' for a CAE were: Communication skills, Strategic thinking, Influencing skills, Negotiation skills, Commercial acumen and Leadership. Yet, when asked to rate the actual performance and competency of their CAEs, many of these same attributes received the lowest ratings. That is, the Audit Committee Members surveyed most frequently rated their CAE's performance as requiring improvement or unsatisfactory in the areas of: Negotiation skills, Influencing skills, Leadership, Strategic thinking and Commercial acumen. By contrast, the capabilities in which CAEs were most commonly rated as excellent or exceeding expectations were: Technical skills, Diplomacy, Communication and Influencing.

These results indicate that while many CAEs are performing to high standards in key aspects of their role, improvement is still required.

In the roundtables, all Audit Chairs agreed that CAEs should play an integral role in strategic discussions among the C-Suite. But to have presence and maintain their 'license' to operate at senior levels, internal auditors must have sound commercial skills. They said CAEs had to earn their C-Suite stripes by proving their contribution improved the business.

The 2014 Survey respondents said the qualifications they considered important for a CAE were: Internal Audit-specific qualifications such as CIA certification (77 per cent); Business qualifications (67 per cent); Accounting (46 per cent) and Occupational/Industry qualifications (39 per cent). Roundtable participants felt less strongly about this and prioritised commercial acumen and leadership abilities over such qualifications. One director commented, "External audit is hiring doctors, engineers and even anthropologists. Why shouldn't internal audit look outside its normal recruiting pool?"

Several roundtable participants suggested that organisations could address commerciality concerns by establishing programs where line personnel, management leaders and specialists are seconded to the internal audit team for a period of time.

"I love traffic lights, charts and graphs – anything that allows me to quickly prioritise or understand a trend."



## Enhancing the profession

The 2014 Survey asked Audit Committee Members to describe the single greatest shortcoming of internal audit which the profession should strive to overcome. Respondents' answers fell into the following key categories:

- Failure to adopt a stronger risk focus
- Inability to gain the respect and buy-in of management
- Poor internal audit reporting
- Lack of commerciality
- Inability to drive practical and meaningful improvements in the organisation
- Failure to meet Audit Committee needs
- Poor internal audit resourcing

The Survey also asked respondents to nominate the standout attribute or contribution from internal audit which they would like to see developed consistently across the profession. Unsurprisingly, the majority of responses represented the positive flipside along the same themes as above:

- Good working relationships and active collaboration between management and internal audit
- Strong relationship between internal audit and Audit Chair
- Improved risk and control culture within the organisation
- Integrated assurance framework
- Independent, concise and insightful reporting
- Commerciality

Roundtable participants agreed that commerciality was the single greatest asset for boosting the status of internal audit. It was central to tackling many related obstacles identified in the survey. For instance, a CAE's practical commercial skills were the foundation for building better relationships with management and the Audit Chair, as well as for identifying whole-of-organisation risks and achieving practical positive outcomes for the organisation. The emphasis on commercial acumen was not limited to private sector respondents, with public sector Chairs desiring equal rigour around citizen outcomes and organisational effectiveness.

## What the Audit Chairs said

- I would question the effectiveness of internal audit if the audit plan was not iterated when significant changes happen or new risks emerge.
- It's not enough to rely on technical arguments that internal audit is good for governance. Then you are just complying for the sake of it. The challenge for internal audit is to ask "how do you add value? How does your presence make this business better?"
- There are two forces pulling the internal audit function which need to be managed carefully. Internal audit must understand how to partner with other stakeholders in the organisation so they can resolve complex, time-sensitive issues quickly and efficiently. But at the same time, you can't be management's best friend because you have a primary responsibility to the board and the organisation.
- Internal audit are still the eyes and ears of the Audit Committee. But their progress on data analytics has been remarkably slow. Today, this is the only way to get across the volume and speed of transactions and satisfy Audit Committees that coverage is adequate. The technology is now good enough – it's up to internal auditors to push into this space.
- Audit Committees have to give the board a view on the overall control health of the organisation. We expect the CEO, CFO and CRO to do the same in their areas so why not internal audit? It's a cop-out for internal audit not to express a view.
- Internal audit has risen up the value chain substantially in the last few years. It has a seat at the table for the full sessions of the Audit Committee and the Risk Committee. But this can't be taken for granted. It will always come down to the calibre of the CAE.



## Further information

The “Achieving High Performance in Internal Audit” study aims to capture developments and trends in the internal audit profession. The report is available on our websites: [www.iaa.org.au](http://www.iaa.org.au) and [www.protiviti.com.au](http://www.protiviti.com.au).

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