Achieving High Performance in Internal Audit
Australia 2010
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Christopher McRostie  
Chief Executive Officer  
The Institute of Internal Auditors  
Australia

I would like to welcome you to the full report of our 2010 benchmarking study.

The IIA’s goal is for the internal audit profession to be recognised as the leading provider of assurance and advice on risk management, internal control and governance. To support the profession to this end, the IIA launched its Policy Agenda earlier this year. The Policy Agenda aims to serve as a benchmark and ‘roadmap’ to best practices for organisations committed to strong risk management assurance.

In reviewing this year’s findings, there are a number of areas where industry practices are increasingly in compliance with our Policy Agenda’s recommendations.

The fact that there has been a significant increase in the number of audit committees that have taken control of the appointment and removal, remuneration and performance of the Chief Audit Executive, is a very positive development. Making internal auditors answerable to the audit committee rather than management goes a long way toward ensuring they have the independence required to report objectively on the organisation without fear or favour.

On the flipside, a crucial area where the profession significantly lags behind the Policy Agenda is in its compliance with the IIA’s international standards of professional practice. For as long as this survey has been conducted, compliance rates have been low and certainly not at a level that is acceptable for a profession that trades on the quality and reliability of the information provided to boards and management. Investors, organisations and the community are entitled to expect more rigour from their assurance providers. Commitment to a single, consistent set of high professional standards is the foundation of any profession, let alone for internal auditors who play such a critical role in governance. If boards, audit committees and internal auditors do not do more to address these deficiencies in a self-led manner, the case for external regulation will only grow stronger.

My thanks go to Protiviti for their ongoing support and efforts in putting together this study. I am also grateful to those who participated in this survey for continuing to provide us with valuable insights into our profession. Finally, I would like to recommend the IIA’s Policy Agenda to you as a guide for building a first-rate framework for internal audit. By all indications, we are making headway as a profession, but there is still some way to go.

Christopher McRostie  
CEO, Institute of Internal Auditors
Key Messages

Gary Anderson
Managing Director
Protiviti

Protiviti is again pleased to collaborate with the IIA in undertaking this important study.

Corporate Australia has emerged from the worst of the global economic downturn and most organisations have pulled through with a keen awareness of ‘lessons learnt’ from the corporate collapses and risk management failures witnessed in that period.

Indeed, one of the survey’s encouraging signs is that good progress was made in strengthening governance over assurance. Many audit committees, particularly in the listed company sector, have removed management control (and perception of control) over internal audit and stepped up their own responsibility for the function. That increasing numbers of audit committees are ‘going into bat’ for the internal audit function attests to the fact that they value its important contribution to assurance and stakeholder confidence.

It is also pleasing to see that the profession is beginning to appreciate the importance of strategic risk which has now featured in the top emerging priorities. Internal auditors are becoming more alert to broadening their frame of reference to risk management of fundamental exposures such as threats to core business models and strategic objectives.

The survey points to a profession that is growing in stature and capability however there is scope for improvement.

An area where performance continues to be poor is adherence to the IIA’s standards for the professional practice of internal auditing (the ‘Standards’). Full compliance with the Standards has fallen to 38 per cent of all organisations surveyed. Quality in internal audit is the source of its value. Directors and management must be able to rely on the integrity, accuracy and objectivity of the information provided by internal audit. Without compliance to the Standards, these basics cannot be assured.

I urge all Chief Audit Executives, boards and audit committees to review their compliance and address deficiencies as a matter of priority.

Internal auditors are staking out a high level of credibility but maintaining it will not be easy. We should continually ask ourselves how we can better meet our stakeholders’ requirements for assurance and insight to help drive the organisation’s success.

I hope you find the results of this survey insightful.

Gary Anderson
Managing Director, Protiviti
Executive Summary
Executive Summary

Authority, Independence and Mandate

There has been a significant improvement by Audit Committees in listed companies exercising their authority in the final decision to appoint and remove the CAE. However, the Audit Committee is still only making these decisions in less than half of all organisations across all sectors.

It is pleasing to see that listed companies have also made other substantial improvements:

- 75% of listed companies now state that their Audit Committee has the final say over appointing or removing the CAE, with only 2% reporting that the CFO has this power (down from 15% in 2009).
- 75% of listed companies now state that their Audit Committee approves the scope and budget for internal audit, while only 5% said the CFO has this role (down from 21% in 2009).
- 43% of organisations have either the Board or Audit Committee set and approve remuneration of the CAE (up from 30% in 2009).
- 61% of organisations have either the Board or Audit Committee evaluate the performance of the CAE (41% in 2009).

These striking improvements may be the result of Boards reacting either to concerns that management had too much influence over internal audit functions, or that pressure and risks from the GFC has prompted a greater desire for Audit Committees to obtain more direct and personal connection with assurance providers in their organisations. Whatever the reason, this improvement, if sustained, is a very positive step towards good practice.

Challenges and Trends

The top 5 areas identified by CAEs as emerging priorities in the next 3 years are:

- Core Financial Controls
- Major Project Implementations
- Risk Management Attestation
- Information Technology
- Strategic Risk

It is not surprising to see core financial controls emerge as the highest priority. Corporate collapses and a focus on liquidity during the past year are likely to have made Boards and Audit Committees concentrate on ensuring that appropriate financial processes exist.

Of greater interest is the inclusion of “strategic risk” for the first time as a top 5 emerging priority. This undoubtedly reflects the influence of the GFC and pressure to understand the major strategic risks and implications of business models more deeply and incorporate these areas in the CAEs program of audits.

Quality

Full compliance with the Standards has decreased slightly from 42% to 38%. Full compliance among unlisted and government organisations has fallen dramatically – 12 percentage points in both cases. It is pleasing to see that the majority (54%) of not for profit organisations now report full compliance. Listed organisations also report an improvement, although full compliance remains in the minority (46%).

These results are not acceptable to the Internal Audit profession. Quality is an essential element of the internal audit process and it is a concern that Boards, Audit Committees and CAEs are not addressing this deficiency.

Internal Audit Resources

Unfilled demand by CAEs for key technical skills to address identified key risk areas remains largely unchanged year on year. Indeed, these results are very similar to other studies for the past decade. This
Executive Summary

reflects the inability of the Internal Audit profession to alleviate this serious resource issue. This is even more concerning given that key areas of unfilled demand such as IT are also identified by CAEs as emerging priority areas.

As a profession we must look at new ways to address these key skill shortages. Audit Committees, executive management, regulators and other stakeholders will not accept a failure to conduct work in key areas due to such skill deficiencies forever. Options may include new resourcing models within businesses, with service providers and others.

Outcomes

While a majority of respondents (96%) provide some form of rating, internal auditors are increasingly being asked to provide opinions. Only 64% of respondents indicated they provide positive opinions (no change from 2009). When asked whether the internal audit function was providing a “macro” opinion on their organisation’s overall internal control environment, as described in the IIA’s recent practice guide, only 29% indicated they are.

Improvement is required to provide appropriate assurance to meet stakeholder requirements, particularly as Boards, Audit Committees and CEOs become more aware of the benefits of obtaining such a macro view. At the same time, the work required to provide a macro opinion presents CAEs with a valuable opportunity to place themselves in the centre of the organisation’s overall assurance effort and position themselves as the key assurance provider to the Board and Senior Management.
About this Study

The study includes a diverse range of sectors and organisations. Participants invited to take part in the survey earlier this year were Chief Audit Executives (CAE) who are current members of Internal Auditors-Australia (IIA). Overall, the profile of participants is similar to the 2009 study.

Organisations by Type – Graph 1

- Data was collected from just over 160 companies.
- Participants in the survey included listed companies (28%), unlisted private companies (14%), federal, state and local government agencies (41%) and not-for-profit organisations (10%).

Organisations by Size – Graph 2

- Small and medium firms represented just under half of the respondents (47%).
- Over one-third of respondents (35%) indicated revenues exceeding AUD 1 billion.
About this Study

Organisations by Industry – Graph 3

- Respondents from the government represented the largest industry taking part in the survey (40%).
- This was followed by financial services (18%) and consumer products & retail (17%).

Organisations by State - Graph 4

- Information was collected across each of the six states and the Australian Capital Territory.
- The highest proportion of respondents came from New South Wales (36%), followed by Queensland (19%) and Victoria (18%).
- A small proportion of respondents were resident outside of Australia.
Authority, Independence and Mandate
Authority, Independence and Mandate

Internal audit’s role in the governance process is optimised when the internal audit is independent from management and reports to individuals with no perceived motivation to limit the scope of internal audit activities. A direct reporting line to the audit committee is best practice.

In this year’s study, the research found there has been a significant improvement by audit committees exercising their authority in having the ultimate decision over appointing and removing the CAE. However, the audit committee is still only making these decisions in less than half of all organisations.

Appointment and Removal of the Chief Audit Executive (CAE) – Graphs 5 and 6

- The Audit Committee Chair is actively involved in the appointment and removal of the CAE, particularly in listed companies (75%).
- The Chief Financial Officer’s involvement in listed companies of this function (2%) has markedly reduced from last year’s results (15%).

Graph 5 - Who Appoints and Removes the CAE?

Graph 6 - Appointment and Removal of CAE by Sector
Authority, Independence and Mandate

Setting the Remuneration and Bonus of the CAE – Graph 7

- The Chief Executive (or equivalent) is primarily involved in setting the remuneration and bonus of the CAE across sectors with the exception of listed companies.
- In listed companies, one-quarter (25%) of CFO's perform this function and there has been an increase of the Board's involvement from last year up from 9% to 18%.

Evaluating the Performance of the CAE - Graph 8

- The Chief Executive (or equivalent) and the Audit Committee is consistently involved in evaluating the performance of the CAE across all sectors.
- In listed companies, the Audit Committee is the final decision-maker regarding CAE performance.

Graph 7 - Setting the Remuneration and Bonus by Sector

Graph 8 - Evaluating CAE Performance by Sector
Authority, Independence and Mandate

Approving the Scope and Budget of Internal Audit – Graph 9

- In three-quarters (75%) of listed companies, the Audit Committee approves the scope and budget of internal audit.

Composition of Audit Committee – Graph 10

- Similar to last year’s results, almost all of the organisations that responded to the study have an audit committee or equivalent body acting in that capacity, which is encouraging.
- However, over one third (37%) do not have an independent chairperson and the audit committee consists largely of executive management.

Graph 9 - Approving Scope and Budget by Sector

Graph 10 - Composition of the Audit Committee
Authority, Independence and Mandate

Private Meetings Without Management – Graph 11

- Almost one-third of CAE's (31%) on average are not having private meetings with the audit committee. (This is now shown on graph below).
- This is consistent throughout sectors and across medium to large organisations.
- The CAE in almost three-quarters (64%) of smaller organisations with turnover less than $100m is not meeting privately with the audit committee without management present. This is an increase of almost 20% from last year’s results.

Graph 11 - CAE Meeting Privately Without Management
Challenges and Trends
Challenges and Trends

Internal audit is a long-standing but rapidly evolving profession, with increasing demands on the extent and scope of work performed. This poses challenges for the profession in meeting new expectations while not losing sight of traditional core areas.

**Level of Change in Structure and Direction – Graph 12**

- The level of change in organisations has significantly stabilised with just under half (43%) indicating no major changes to structure, roles or reporting lines during last 12 months.

**Change of Scope of Internal Audit in Last 12 Months – Graph 13**

- Assurance on risk framework and consulting / advisory audits are areas that have significantly or somewhat increased – 50%. For the most part, there has been no change to the scope of internal audit in the last 12 months.

**Graph 12 - Change in Structure and Direction of Internal Audit in the Last 12 Months**

**Graph 13 - Change in Scope of Internal Audit in the Last 12 Months**

- Overall size of plan (days)
  - Significantly decreased: 7% / 2%
  - Somewhat decreased: 45% / 26%
  - No change: 34% / 25%
  - Somewhat increased: 13% / 14%
  - Significantly increased: 13% / 8%

- Financial process audits (including external audit support)
  - Significantly decreased: 9% / 4%
  - Somewhat decreased: 58% / 30%
  - No change: 26% / 14%
  - Somewhat increased: 4% / 8%
  - Significantly increased: 13% / 8%

- Operational audits
  - Significantly decreased: 5% / 5%
  - Somewhat decreased: 50% / 30%
  - No change: 30% / 14%
  - Somewhat increased: 14% / 8%
  - Significantly increased: 13% / 8%

- Compliance audits (laws, regulations and policy)
  - Significantly decreased: 9% / 5%
  - Somewhat decreased: 55% / 32%
  - No change: 25% / 18%
  - Somewhat increased: 8% / 12%
  - Significantly increased: 13% / 8%

- Consulting / advisory
  - Significantly decreased: 5% / 5%
  - Somewhat decreased: 44% / 36%
  - No change: 32% / 14%
  - Somewhat increased: 18% / 12%
  - Significantly increased: 13% / 8%

- Assurance on Risk Framework
  - Significantly decreased: 3% / 3%
  - Somewhat decreased: 44% / 36%
  - No change: 32% / 14%
  - Somewhat increased: 18% / 12%
  - Significantly increased: 13% / 8%

- N/A: 0%
Challenges and Trends

Change of Scope of Internal Audit in the Next 12 Months – Graph 14

- Almost two-thirds of organisations (65%) expect that assurance on risk frameworks will increase over the next 12 months.
- Financial audits are likely to stay at the same levels for well over half of organisations (61%).

Emerging Priorities for Internal Audit in the Next 3 years – Graph 15

- This year, respondents ranked the top six nominated emerging priorities over the next 3 years (in order of priority) as core financial controls, major project implementations, risk management attestation, IT, strategic risk (not asked in 2009) and fraud.

Graph 14 - Change in Scope of Internal Audit in the Next 12 Months

Graph 15 - Emerging Priorities in the Next 3 Years
Challenges and Trends

Adjusting Internal Audit Activity as the Economy Recovers – Graph 16

- Almost half of organisations (46%) indicated that the global financial crisis has had no material impact on their internal audit activity - up from 42% last year.
- Over one-third (26%) stated that the internal audit budget will face cost pressures as a result of the GFC - a reduction of 10% from last year.

Graph 16 - Adjusting Internal Audit Activity as the Economy Recovers

<table>
<thead>
<tr>
<th></th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>No material impact</td>
<td>42%</td>
<td>46%</td>
</tr>
<tr>
<td>New areas/areas brought forward on the audit plan</td>
<td>33%</td>
<td>34%</td>
</tr>
<tr>
<td>Cost pressures on the internal audit budget</td>
<td>36%</td>
<td>26%</td>
</tr>
<tr>
<td>Change in control environment as a result of restructuring</td>
<td>21%</td>
<td>20%</td>
</tr>
<tr>
<td>Increases in the internal audit budget</td>
<td>12%</td>
<td></td>
</tr>
<tr>
<td>Other (please specify)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Graph 16 - Adjusting Internal Audit Activity as the Economy Recovers
Quality
Quality

This section asked participants to indicate how they ensured quality and professionalism in their teams and functions. Disappointingly, despite seeing the importance of membership, certification, quality programs and compliance with the Standards, improving quality across a range of areas has decreased during the last 12 months.

Ensuring Quality in Internal Audit – Graph 17

- Respondents revealed in the majority of organisations (79%) that the best way to ensure quality in their internal audit activity was to comply with the Standards, a decrease of 8% from 2009.
- Internal audit team membership of the IIA has reduced slightly to 7.5 out of 10 in organisations (75%).

Graph 17 - Ensuring Quality in Internal Audit

Compliance with the IIA Standards 2009: 87%, 2010: 79%
IA Staff Membership (IIA) 2009: 79%, 2010: 75%
Quality program ISPPA Standard 1310 2009: 55%, 2010: 53%
IA Staff Certification (CIA) 2009: 43%, 2010: 40%
Reports Signed Off by CIA 2009: 31%, 2010: 31%
Other 2009: 10%, 2010: 21%
Quality

Level of Compliance with the Standards – Graphs 18 & 19

- Despite acknowledgement of the importance of adherence to the Standards, just over one-third (38%) of respondents indicated they fully complied with the Standards, with 58% indicating partial compliance and 4% unsure.
- The level of compliance to the Standards is relatively consistent across all sectors and organisation size.
- Listed companies and not-for-profit organisations (46% and 54%) have a higher level of full compliance than unlisted and government organisations (26% and 37%).

Graph 18 - Level of Compliance with the Standards

Graph 19 - Level of Compliance with the Standards by Sector
Quality

Last External Quality Assessment Review – Graph 20 and 21

- The Standards require quality assessment of the internal audit function at least every five years with internal quality processes to be performed on an ongoing basis.
- Less than half (42%) of respondents have never completed an external quality assessment.
- Less than one-fifth (17%) have completed an assessment within the last 12 months – a slight reduction from 2009.
- In the last 3 years, nearly half of all government organisations and unlisted companies (48% respectively) have completed an external quality assessment.

Graph 20 - Last External Quality Assessment Review

- 2010: 23% within the last 12 months, 25% 1-3 years ago, 8% 4-5 years ago, 3% more than 5 years ago, 43% never completed, 5% do not know.
- 2009: 20% within the last 12 months, 25% 1-3 years ago, 6% 4-5 years ago, 3% more than 5 years ago, 6% never completed, 5% do not know.

Graph 21 - Last External Quality Assessment by Sector

- Listed Company: 23% within the last 12 months, 32% 1-3 years ago, 15% 4-5 years ago, 10% more than 5 years ago, 46% never completed, 3% do not know.
- Unlisted Private Sector Company: 16% within the last 12 months, 28% 1-3 years ago, 10% 4-5 years ago, 8% more than 5 years ago, 47% never completed, 5% do not know.
- Government: 0% within the last 12 months, 5% 1-3 years ago, 8% 4-5 years ago, 0% more than 5 years ago, 52% never completed, 0% do not know.
- Not for profit: 20% within the last 12 months, 21% 1-3 years ago, 5% 4-5 years ago, 0% more than 5 years ago, 5% never completed, 3% do not know.
Internal Audit Resources
Internal Audit Resources

As internal audit’s scope continues to broaden, skills and resources need to evolve to keep pace. This section outlines key findings in this area.

Number of Full Time Equivalent Personnel in Internal Audit - Graph 22

- Almost 6 in 10 organisations employ between 1 and 5 FTE’s in their internal audit department – very little change from 2009.
- The average number of full time internal audit employees in an in-house capacity across all sectors is 8. Listed companies employ 15 internal auditors in-house on average, compared to 7 in the government and 3 in private or not for profit organisations.

Graph 22 - Growth of FTE Personnel in Internal Audit

Table 1 - Average Number of Full Time Internal Audit Employees Across Sectors

<table>
<thead>
<tr>
<th>Average employees per sector</th>
<th>Listed Companies</th>
<th>Unlisted Private Sector Company</th>
<th>Government</th>
<th>Not for profit</th>
</tr>
</thead>
<tbody>
<tr>
<td>In - House</td>
<td>15</td>
<td>3</td>
<td>7</td>
<td>3</td>
</tr>
<tr>
<td>Co - Sourced</td>
<td>4</td>
<td>3</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>Outsourced</td>
<td>4</td>
<td>1</td>
<td>3</td>
<td>1</td>
</tr>
</tbody>
</table>
Internal Audit Resources

Unfilled Demand for Key Technical Skills - Graph 23

- The top three key technical skills where there is high or very high unfilled demand are IT (45%), risk management (38%) and operations (32%).
- The top demands for technical skills in 2009 continue to be the highest demand skills in 2010 with even greater demand placed on them this year.
- While there is still demand for financial and accounting skills, there is more demand for project management.

Staff Retention - Graph 24

- One in three organisations are concerned about keeping staff. Listed organisations are the most concerned (43%), while government organisations have the least concern overall.
- Reasons for concerns include price pressures, stability, growth opportunities, high demand for talent particularly as the economy recovers.

Graph 23 - Unfilled Demand for Technical Skills

<table>
<thead>
<tr>
<th>Skill</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>IT skills</td>
<td>45%</td>
<td>45%</td>
</tr>
<tr>
<td>Risk management</td>
<td>33%</td>
<td>38%</td>
</tr>
<tr>
<td>Operations</td>
<td>26%</td>
<td>32%</td>
</tr>
<tr>
<td>Project management</td>
<td>21%</td>
<td>29%</td>
</tr>
<tr>
<td>Financial and accounting</td>
<td>17%</td>
<td>19%</td>
</tr>
<tr>
<td>Treasury and Finance</td>
<td>13%</td>
<td>10%</td>
</tr>
<tr>
<td>Environment and sustainability</td>
<td>10%</td>
<td>9%</td>
</tr>
<tr>
<td>Other</td>
<td>10%</td>
<td>9%</td>
</tr>
</tbody>
</table>

Graph 24 - Staff Retention

<table>
<thead>
<tr>
<th>Concern Level</th>
<th>Listed Company</th>
<th>Unlisted Private Sector Company</th>
<th>Government</th>
<th>Not for profit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very concerned</td>
<td>11%</td>
<td>14%</td>
<td>16%</td>
<td>6%</td>
</tr>
<tr>
<td>Somewhat concerned</td>
<td>32%</td>
<td>28%</td>
<td>14%</td>
<td>14%</td>
</tr>
<tr>
<td>A little concerned</td>
<td>23%</td>
<td>23%</td>
<td>24%</td>
<td>18%</td>
</tr>
<tr>
<td>Not at all concerned</td>
<td>39%</td>
<td>44%</td>
<td>38%</td>
<td>39%</td>
</tr>
</tbody>
</table>

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Internal Audit Resources

Internal Audit Certification - Graph 25

- Respondents were asked whether they were a Certified Internal Audit (CIA). Over half (54%) are not certified while 28% of respondents are certified representing a decrease from last year. The remainder have intentions to become a CIA in the future.
Outcomes

For the value of the internal audit function to be understood by the organisation, appropriate accountability frameworks must be in place for internal audit so that results are achieved and communicated in a transparent way. This section outlines key findings in this area.

Reliance by External Auditor - Graphs 26 and 27

- A coordinated approach between internal and external auditors prevents duplication of effort and presents a holistic assurance plan to the Audit Committee. It also facilitates the placement of reliance on internal audit work.
- In the last 12 months, the extent of reliance by the external auditor has reduced. 42% of CAEs reported the extent of reliance in the form of a coordinated approach with a high degree of reliance placed on internal audit work. This represents a 5% decrease from last year’s results.
- Coordinated approaches are more common in the listed or private sector.
- One in ten listed companies and unlisted companies place no reliance on the work of internal audit by the external auditor.

Graph 26 - Extent of Reliance by External Auditor

Graph 27 - Extent of Reliance by External Auditor by Sector
Outcomes

Reporting – Graphs 28, 29 and 30

- Accountability was mixed for monitoring corrective action.
- 44% of respondents indicated that internal audit and management have the primary responsibility for monitoring corrective action – a slight increase from last year.
- Almost half of respondents (43%) use a hybrid model to track actions arising from audits using Standard 2500.

Graph 28 - Audit Issue Resolutions

Graph 29 - Actions Tracked Arising from Audit (Standard 2500)
Outcomes

Providing Macro Opinions – Graph 31

- Almost half of listed companies (45%) are providing macro opinions (as described in IIA-Australia’s recent practice guide).
- Around three-quarters of unlisted and not for profit organisations are not providing macro opinions (72% and 75% respectively).
Outcomes

Providing assurance opinions – Graphs 32 and 33

- Internal audit is increasingly being asked to provide audit opinions. Respondents reported that the majority of opinions provided were positive and capable of confirming reasonable assurance.
- On average, just under one fifth (18%) of respondents do not provide assurance opinions – a decrease from last year’s results.
- One-in four listed companies (25%), do not provide assurance opinions.

Graph 32 - Providing Assurance Opinions

Graph 33 - Providing Assurance Opinions by Sector
IIA provides internal auditing practitioners, executive management, boards of directors and audit committees with standards, guidance and information on internal auditing best practices. Established in Australia in 1952, the IIA has chapters across the country. Globally, the IIA serves more than 160,000 members in internal auditing, governance and internal control, IT audit, education and security from more than 165 countries.

Protiviti (www.protiviti.com.au) is a global business consulting and internal audit firm composed of experts specialising in risk, advisory and transaction services. The firm helps solve problems in finance and transactions, operations, technology, litigation, governance, risk, and compliance. Protiviti’s highly trained, results-oriented professionals provide a unique perspective on a wide range of critical business issues for clients in the Americas, Asia-Pacific, Europe and the Middle East.