

# ENHANCING VALUE THROUGH COLLABORATION: A CALL TO ACTION

GLOBAL REPORT – JULY 2014





# AUDIT EXECUTIVE CENTER®

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## ABOUT THIS DOCUMENT

The information included in this report is general in nature and is not intended to address any particular individual, internal audit function, or organization. The objective of this document is to share information and other internal audit practices, trends, and issues. However, no individual, internal audit function, or organization should act on the information provided in this document without appropriate consultation or examination.

## ABOUT THE AUDIT EXECUTIVE CENTER

The IIA’s Audit Executive Center is the essential resource to empower CAEs to be more successful. The Center’s suite of information, products, and services enables CAEs to respond to the unique challenges and emerging risks of the profession. For more information on the Center, visit [www.theiia.org/cae](http://www.theiia.org/cae).

## INTRODUCTION

Executive management constantly challenges internal audit to explain how the function creates value, to justify its role, and suggest ways to take the organization to the next level. For a CEO, the focus on creating value is valid, but protecting value is just as, or more, important. Internal audit demonstrates value by providing assurance and advisory services — although the dynamic of these competencies are evolving.

Stakeholders are seeking, if not demanding, guidance from internal audit to address strategic and emerging business risks. Results from the 2014 Pulse of the Profession survey indicate a global shift toward greater coverage of risk management, business strategy, and governance. At the same time, PwC reports that “as the interconnectedness of risks and pace of change continue to increase, continually adjusting and gaining alignment on internal audit expectations is critical to obtaining significant value where it matters most.” Addressing this challenge, IIA Vice President of Professional Services Gina Eubanks notes, “Every company, situation, and leader is different.” She asks, “Are you ready to sit down with your stakeholders to understand how they define and measure the success of internal audit?”

“Traditionally, internal audit has been reactionary, but that approach is changing. Our value to an organization depends on furthering this change in course.”

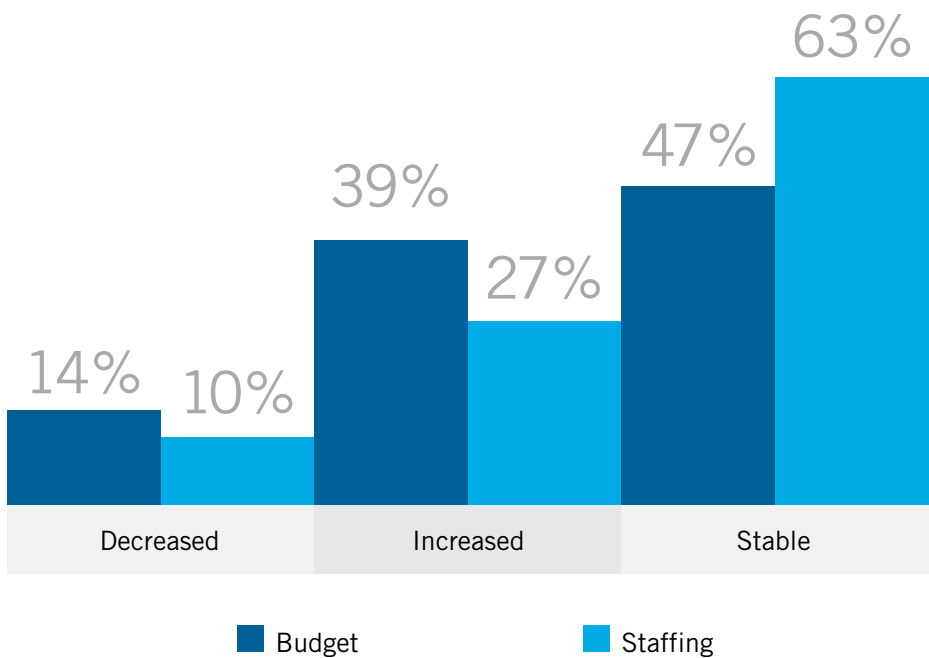
— Richard Chambers,  
IIA President and CEO

Annually, The IIA's Audit Executive Center Global Pulse of the Profession survey assesses the course of internal auditing, both by measuring year-over-year trends and evaluating emerging issues. This year, the Audit Executive Center surveyed 1,935 audit professionals around the world. Among respondents, 1,160 CAEs participated in the survey globally.

Taking a holistic view, the 2014 Global Pulse of the Profession report cross-references the survey findings with thought leadership from some of the world's top management consultancies, which drew their conclusions from similar surveys. By pooling the combined wisdom of KPMG International's (KPMG's) Global Audit Committee Survey, PwC's State of the Internal Audit Profession Study, Protiviti's Internal Audit Capabilities and Needs Survey, and the Pulse of the Profession Survey, this report provides a robust view of challenges facing internal auditing along with strategies to overcome those challenges.

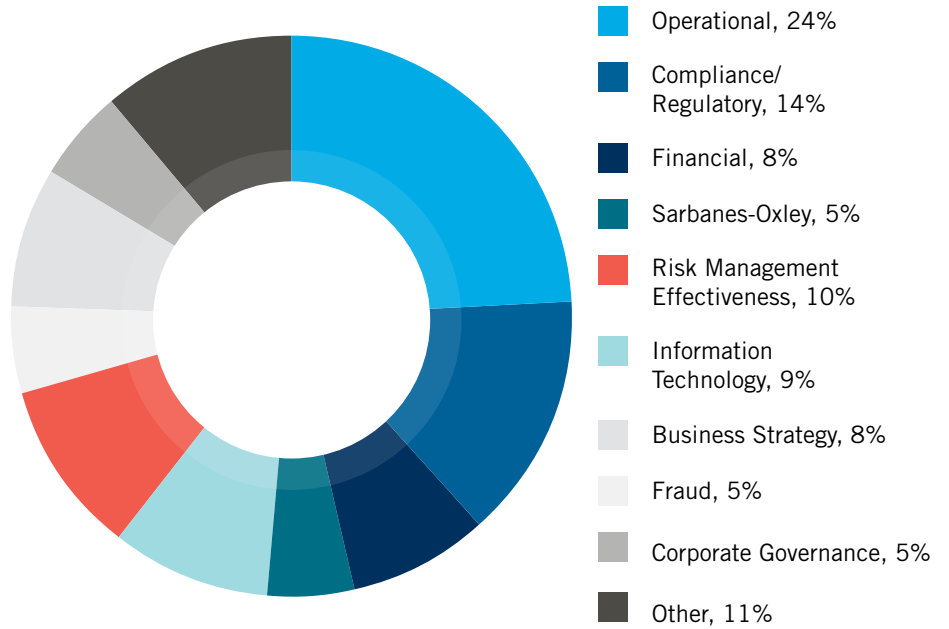
As results from this year's Pulse of the Profession survey show, audit committees and external management continue to invest in internal audit. The majority of surveyed CAEs forecast sustained or increased resource levels for internal audit (Figure 1), indicating that stakeholders maintain the mindset that internal audit is a justified use of resources. As internal audit functions mature and internal controls become well established, this opens up the opportunity to move beyond an assurance function to combined assurance and advisory services.

Figure 1. Change in budget and staffing levels from 2013 to 2014



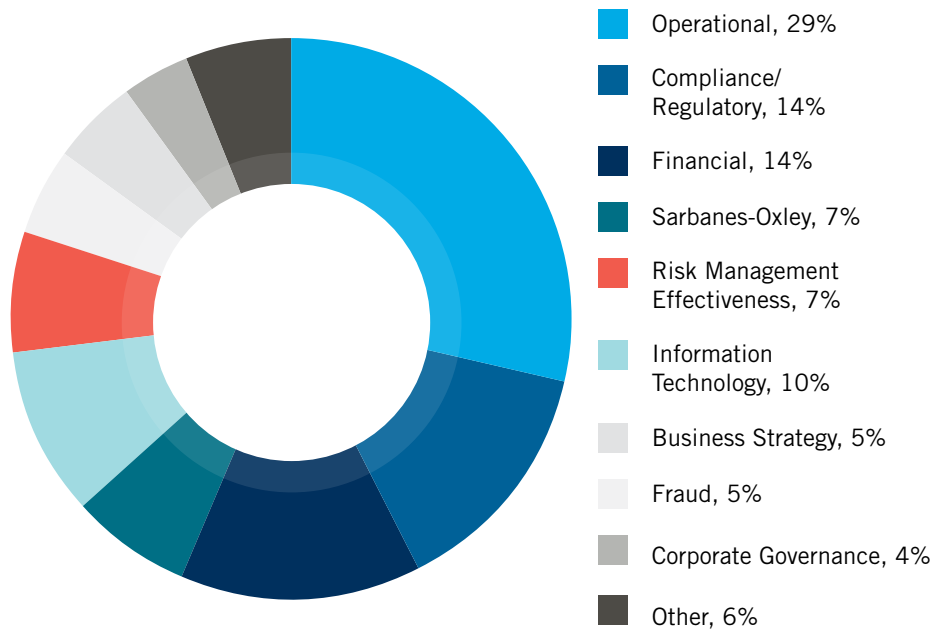
Source: The IIA's Audit Executive Center Global Pulse of the Profession survey, 2014. This chart reflects data from the global CAE respondents of the survey.

Figure 2. Composition of audit plan coverage in 2014



Source: The IIA's Audit Executive Center Global Pulse of the Profession survey, 2014. This chart reflects data from the global CAE respondents of the survey. Total may not equal 100 percent due to rounding.

Figure 3. Composition of audit plan coverage in 2013



Source: The IIA's Audit Executive Center Global Pulse of the Profession survey, 2014. This chart reflects data from the global CAE respondents of the survey. Total may not equal 100 percent due to rounding.

Comparison of the audit plan composition for 2014 and 2013 (Figures 2 and 3) supports the notion that internal audit is broadening its audit coverage. Globally, the number of operational and financial audit hours have been reduced in proportion to audit hours covering business strategy, risk management effectiveness, and governance. The wider range of audit activities in the average audit plan suggests stakeholders are expecting and entrusting coverage of more risk areas to internal audit.

Indeed, KPMG's Global Audit Committee Survey also supports this conclusion, indicating that more than 80 percent of respondents in KPMG's survey say internal audit's role should extend beyond the adequacy of financial reporting and controls to include key risks, especially escalating threats such as information technology and data management. Significant to note, however, is that only 50 percent of respondents say internal audit currently has the skills and resources to be effective in the role they envision. While internal auditing has the support needed for a necessary transformation, obstacles remain.

“In the past, internal auditors commonly dealt with accounting and financial reporting or operational audits and investigations.

The change in audit plan composition shows a transformation. I believe our profession is on the right path.”

—Tolga Usluer, Deputy CAE,  
Finansbank

## FIVE STRATEGIES FOR INTERNAL AUDIT SUCCESS IN THE YEAR AHEAD

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The challenges before internal auditing are various. One need only read their newsfeed to see how the pace of change and advances in technology require that the profession expand to a skillset that includes far more areas than were expected in the previous century. Internal audit touches on every aspect of business from the boardroom to the front line. Such a broad landscape makes it increasingly likely that gaps exist with stakeholder expectations — whether in regard to audit plan coverage or the necessary subject matter expertise.

Of course, as an internal audit function matures and the CAE is confident about the controls in place, there is more opportunity to expand on advisory services. While assurance will always be the primary function of internal audit, advisory services are essential in enabling the company to implement effectively controlled and efficiently run processes. Sustained levels of resources noted previously in Figure 1 positions internal audit to move confidently into this role.

Recognizing the critical and emerging risks facing an organization is essential to an advisor relationship with stakeholders. Or as Sprint CFO Joe Euteneuer tells PwC, “internal audit’s mandate is to be proactive in helping us forecast, assess, and manage risk. They are expected to partner with the business as they manage day-to-day operations and be an ‘idea tank’ for insights around risks and controls for the overall benefit of the company.” The question remains — how does internal auditing become a trusted advisor? Five strategies to move forward are presented for your consideration.

## Improve Upon Alignment With Expectations of Key Stakeholders

Strategic business risk is the top concern among stakeholders. As shown in Table 1, CAE respondents to The IIA's survey believe that both the audit committee and executive management classify their top risks as strategic business risks. More specifically, of the respondents who identified the top five risks the **audit committee** is focusing the greatest level of attention on, 37 percent identified at least one that fell into the strategic business risk category. Of the respondents who identified the top five risks **executive management** is focusing the greatest level of attention on, 45 percent identified at least one that fell into the strategic business risk category. Meanwhile, business strategy remains a relatively small (8 percent), but growing, part of the overall audit plan (Figure 2).

**Table 1.** Risk category for top five risks on which audit committees and executive management is focusing the greatest level of attention in 2014

Audit Committee	Executive Management
Strategic Business Risks	Strategic Business Risks
Operational	Operational
Compliance/Regulatory	Compliance/Regulatory
Information Technology	Information Technology
Risk Management Effectiveness	Cost/Expense Reduction

*Source: The IIA's Audit Executive Center Global Pulse of the Profession survey, 2014. This chart reflects data from the global CAE respondents of the survey.*

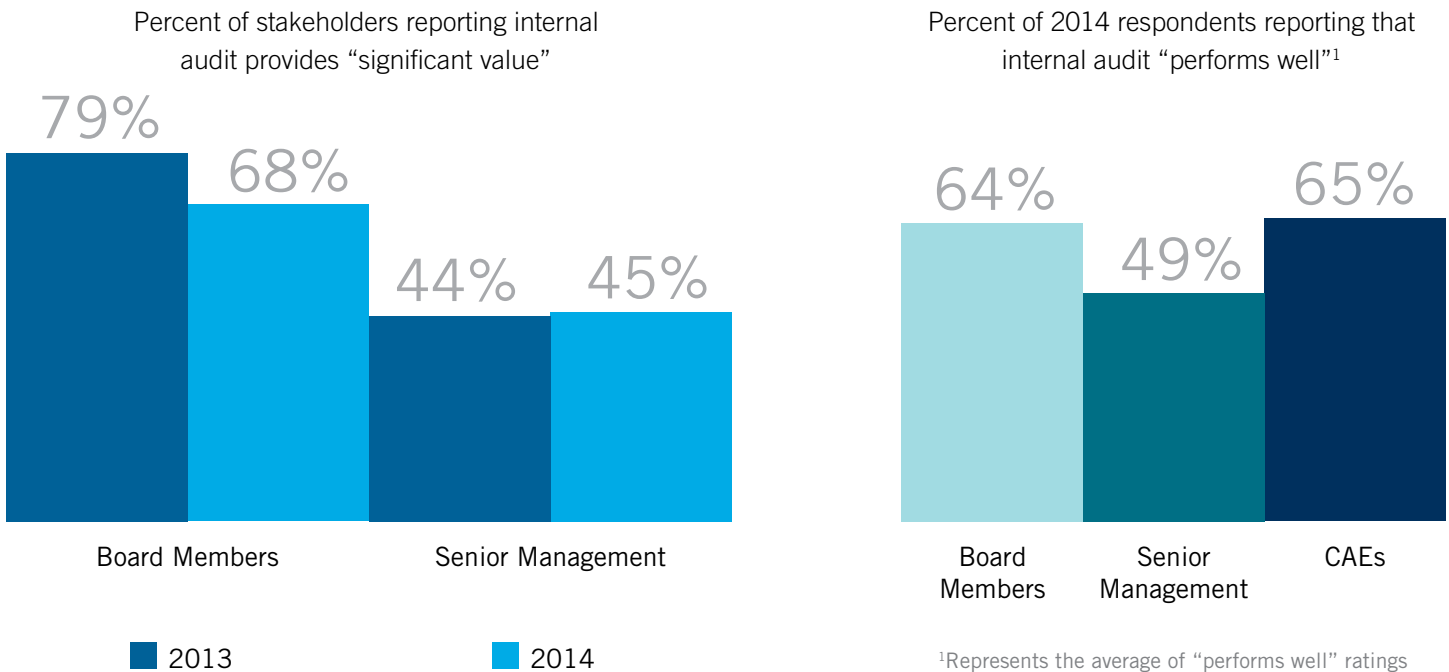
Similarly, PwC survey results — which reflect the opinions of more than 1,900 CAEs, internal audit managers, senior management, and board members — indicate significant dissatisfaction with internal audit value and performance. Taking into account the respondents who did not know whether internal auditing adds significant value to the organization, the survey results show that 50 percent of senior management and nearly 28 percent of board members believe internal auditing adds less than significant value to their organization. Furthermore, only 49 percent of senior management and 64 percent of board members believe internal auditing is performing well at delivering on expectations (Figure 4). Also noteworthy, the belief among board members that internal audit adds significant value has dropped 10 points from last year. Evident from these findings, an expectation gap exists between stakeholders and the internal audit activity.



Setting the tone for alignment by collaborating with stakeholders is imperative. The charter should be utilized to establish priorities and expectations. The first step, according to KPMG’s report, is to “recognize that internal audit is most effective when it is focused on the critical risks to the business, including key operational risk and related controls — not just compliance and financial reporting risks.”

Internal audit needs to shift its mindset and be cognizant of an ever-changing operating environment. KPMG urges the pursuit of a new line of questioning: What are the risks, for example, posed by the extended (global) organization — sourcing, outsourcing, sales, and distribution channels?

Figure 4. Satisfaction with internal audit value and performance



Source: PwC’s State of the Internal Audit Profession Study, 2014.

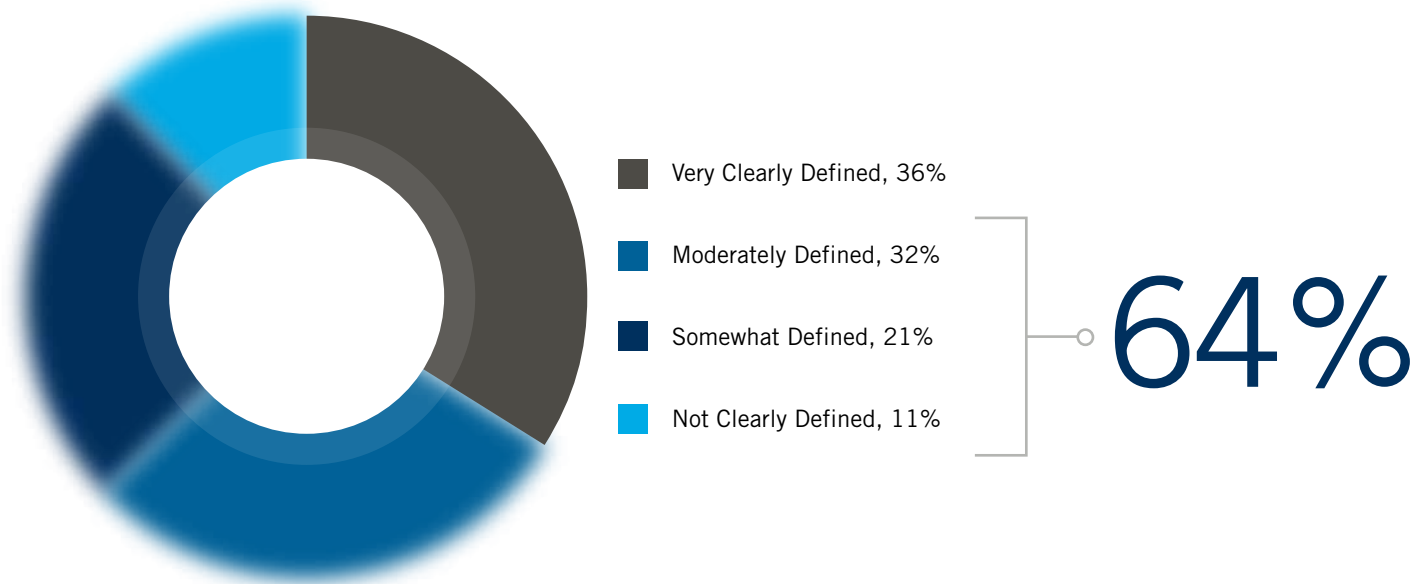
Presuming maturity of the company’s internal control structure, the CAE should present a strategic internal audit plan, spanning three to five years and showing a reduction in assurance services and an increase in advisory services — in accordance with what the internal control structure will permit. The CAE should not lose sight of the need for flexibility and adaptability in response to emerging risks. Such a plan should present in detail how those advisory services will be performed and how they tie into the company’s business plan.

## Assume a Leadership Role in Coordinating the Second and Third Lines of Defense

The IIA advocates educating key stakeholders on the three lines of defense model, comprising management controls, risk management, and internal audit. Communicating this model and coordinating with other assurance providers has made slow progress. As demonstrated by Figure 5, CAE respondents to The IIA's survey recognize that there is an overlap in the three lines of defense: 36 percent of CAE respondents indicate that their organization has very clearly defined distinctions between the different lines of defense, leaving a full 64 percent of CAEs who believe their organization has only moderately, somewhat, or not clearly defined lines of defense.

Figure 5. Distinctions between the lines of defense

Regarding the clarity between your organization's various "lines of defense," how clear are the distinctions between the roles of internal audit and your organization's management, risk, compliance, and control functions?



Source: The IIA's Audit Executive Center Global Pulse of the Profession survey, 2014.  
This chart reflects data from the global CAE respondents of the survey.

Failure to work in concert has consequences. An uncoordinated structure can lead to organizational silos, which can be detrimental to performance during turmoil. Furthermore, if stakeholders do not understand the distinction between functions, they can make the presumption that one or another is dispensable. To combat this viewpoint, the CAE may note, as stated in IIA–Spain’s advisory paper, A Framework for Internal Audit’s Relationship with Other Assurance Providers, “Independent assurance relies ultimately with the third line of defense and specifically on internal audit.”

Internal audit can take a key step toward enhancing its value to the organization by improving cooperation and efficiency among the lines of defense. “The CAE should assume a leadership role in getting everyone back in their lanes, ensuring that there is no duplication or gaps in coverage,” notes IIA President and CEO Richard Chambers.

By establishing distinct roles for each and improving collaboration, organizations vastly improve their ability to identify and manage risks across the full scope of their business. Most importantly, they can minimize gaps in coverage, avoid duplicating efforts and deploy resources more efficiently.

To achieve this, PwC recommends:

- Holding regular meetings between internal audit and risk management groups to share information and align on top risks.
- Creating an integrated view of risk across the organization.

## Enhance Internal Auditing's Capability to Address Critical Strategic Business Risks

In separate surveys, both CAEs and stakeholders identify similar areas of concern. CAE respondents to The IIA's survey report the specific risks that they perceive as garnering the most attention from stakeholders. Approximately 60 percent of those risk areas fall under four risk categories: strategic business risk, operational, compliance, and information technology.

Similarly, KPMG's survey of management and audit committee members identifies hot topics that need to be better addressed by internal audit (Figure 6). The top areas that stakeholders would like internal audit to devote more time to are risk management processes (65 percent), information technology and data management (58 percent), operational risks (52 percent), and compliance and regulation (45 percent).

Internal audit must enhance its capability to address this broadened scope, making sure they have the right understanding of the business and the industry. What are the critical and emerging risks facing the organization?

Figure 6. In the year ahead, in which of the following areas would you like your internal audit function to devote more of its time and/or sharpen its focus? (Select all that apply.)



Source: KPMG International's Global Audit Committee Survey, 2014. This chart reflects data from only those respondents who indicated that internal auditing's roles and responsibilities should extend beyond the adequacy of financial reporting and controls.

“It becomes incumbent on CAEs to communicate clearly where within their audit plans they have identified and addressed the organization’s key strategic and business risks. Explicit rather than implicit communication with full transparency is needed to avoid any misunderstanding of this critical risk coverage.”

— Richard Anderson, Clinical Professor of Risk Management, DePaul University

The following need consideration when moving into the territory of strategic business risk:

- Enterprise Risk Management — internal audit should play a leadership role in implementation.
- Systems development life cycle — a formalized risk process for internal audit involvement in new systems changes in operational processes, and centralization/standardization projects should be established.
- Lean and Six Sigma processes — internal audit staff should have a spectrum of experience.
- Emerging technologies — sourcing and recruiting necessary information technology knowledge is essential.
- Emerging global interaction — early exposure to the business plan sets internal audit up for greater success.

## Develop and Implement Knowledge and Talent Acquisition Strategies

“Acquiring the right people is not the end, it’s the means,” Chambers states. “Acquiring the right people is the means toward having the knowledge and capability in the organization to address a full spectrum of risk.” With organizations facing a broad spectrum of complex risks, CAEs recognize a gap in the knowledge and talent within their staff. Only after internal audit aligns with stakeholders’ expectations and jointly establishes new priorities can it assess its capabilities to effectively tackle them. Such an evaluation goes far beyond conducting conventional headcounts and effectively ascertains the availability of specific skills and personnel — or the lack thereof.

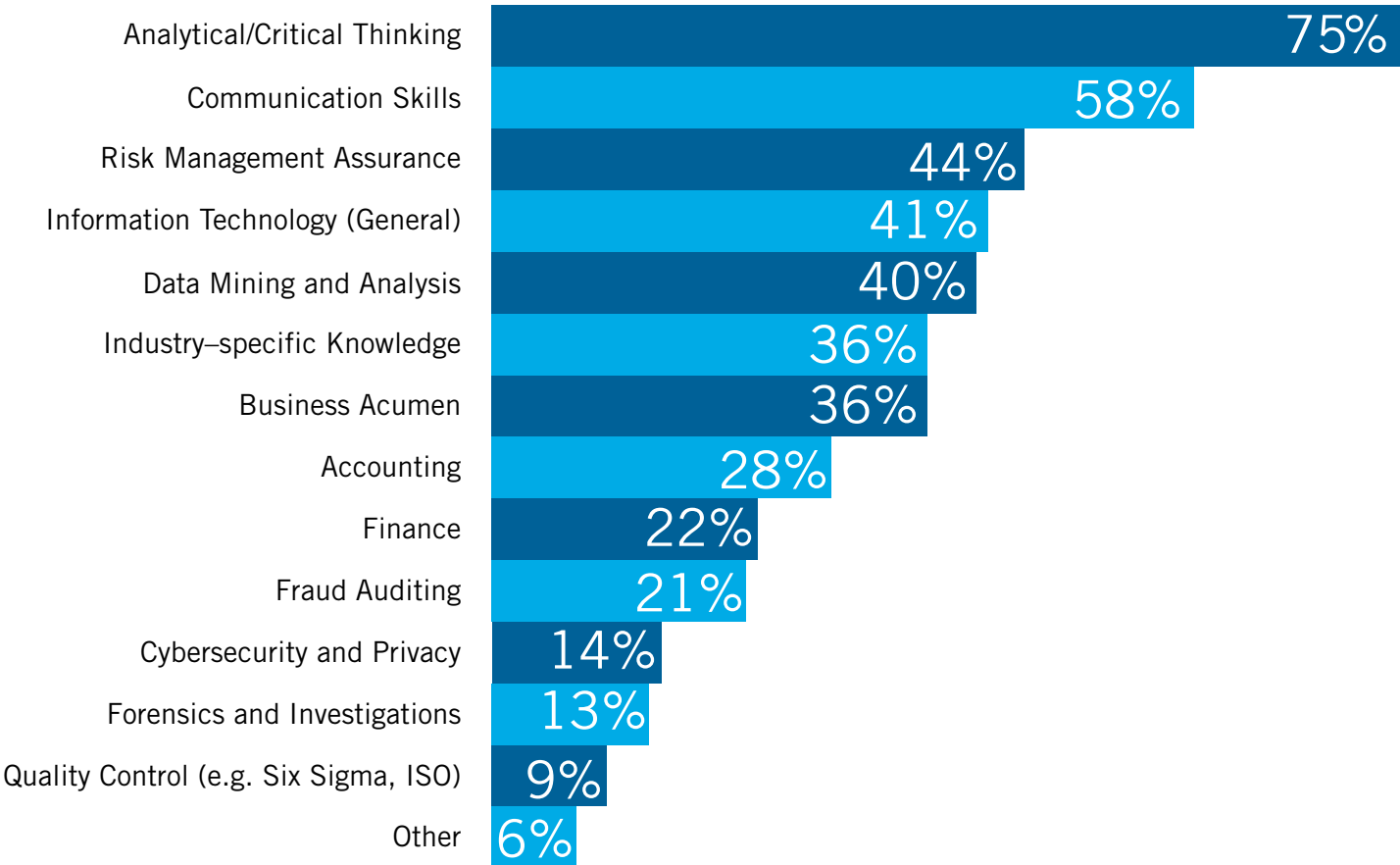
Fewer than half (49 percent) of senior management responding in PwC’s survey believe that internal audit is performing well at obtaining, training, and/or sourcing the right level of talent and the right specialists for its needs. The PwC report surmises, “As the right talent model is imperative to delivering on expectations, it is no wonder that there is such a correlation between stakeholders’ views about skillset development and their views about internal auditing’s overall performance.” There are several ways to close this gap — cosourcing, recruiting, and training. The key is to identify the gap and close it.

Such deficiencies are redefining how organizations build their internal audit function. As shown in Figure 7, only 28 percent of global CAE respondents to The IIA’s survey recruit for accounting skills. By comparison, business acumen and industry-specific knowledge were both sought by 36 percent of respondents. Also noteworthy, analytical thinking and communication skills are among top recruited skills — 75 percent and 58 percent, respectively.

“Understanding the expectations together with the business and challenges to the business requires not only technical skills but also advanced communication, analytical thinking, and problem solving skills.”

—Tolga Usluer, Deputy CAE,  
Finansbank

Figure 7. What skills are you recruiting or building the most in your internal audit function?



Source: The IIA's Audit Executive Center Global Pulse of the Profession survey, 2014. This chart reflects data from the global CAE respondents of the survey. Respondents selected up to five responses.

Internal audit professionals of all levels surveyed in Protiviti's 2014 Internal Audit Capabilities and Needs Survey similarly identify areas of business acumen, such as public speaking, dealing with confrontation, persuasion, and negotiation, as areas that need improvement. In their survey report, Protiviti notes that such skills "in tandem with technical skills...help strengthen relationships inside and outside their functions and their organizations." Furthermore, Protiviti concludes, "Deeper, more meaningful collaboration can help internal auditors address nearly every item on their lengthy priority lists. By developing and sustaining deep and constructive partnerships throughout the business, internal auditors can ensure that their expertise is applied in advance of strategic decisions — that is to say, with sufficient proactivity."

## Become a Trusted Advisor to the Audit Committee and Executive Management

In conclusion, the final strategy proposed here summarizes an attainable opportunity at hand for the profession. CAEs are well equipped to form advisor relationships with stakeholders and, more importantly, educate them about emerging risks and mitigation activities. Such guidance likely will be welcomed and valued, especially when audit committees acknowledge their growing workload is straining capabilities.

More than 40 percent of audit committee members in the KPMG survey say it is increasingly difficult to oversee major risks on its agenda in addition to carrying out its core duties (Figure 8). In fact, one in four have reallocated responsibilities, and some even have created new committees to exclusively address a specific risk, for example, compliance (5 percent) or technology (4 percent).

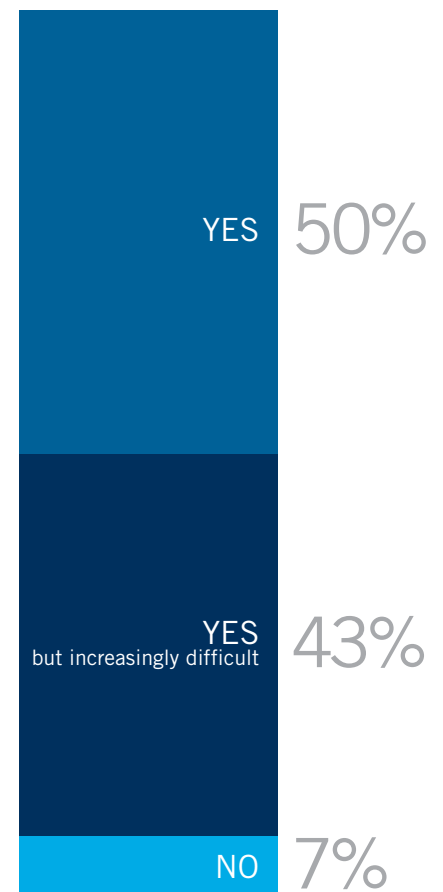
The leadership role CAEs can play in promoting communication and education cannot be emphasized enough. That is particularly true when addressing a topic such as technology, which is perceived as both a real and unknown risk. In this case, internal audit can ensure transparency and goal alignment with audit committees by taking actions such as:

- Meeting regularly with the board and senior management to reassess top risks.
- Building strong relationships with the organization's IT department.
- Fostering direct dialogue between board members and the CIO.
- Auditing the IT infrastructure as well as its operations.

As Senior Vice Chairman of The IIA Global Board of Directors Anton van Wyk explains, "The world as we know it is changing and so must the role played by internal auditing ... In recognition of the multitude of dependencies and impacts that exist, the concepts of integrated thinking and reporting, formalized stakeholder engagement, and the annual integrated report are ways of ensuring internal auditing views business more holistically."

Ultimately, providing such proactive strategic advice is the end goal. As demonstrated throughout this report, it is more than achievable by learning and aligning with the organization's critical goals, building a team with diversified skills, and practicing collaboration. Such steps will not only preserve internal auditing, but ensure its evolution into what it must become: a trusted advisor.

Figure 8. Are you satisfied that your audit committee has the time and expertise to oversee the major risks on its agenda in addition to carrying out its core oversight responsibilities?



Source: KPMG International's Global Audit Committee Survey, 2014.





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