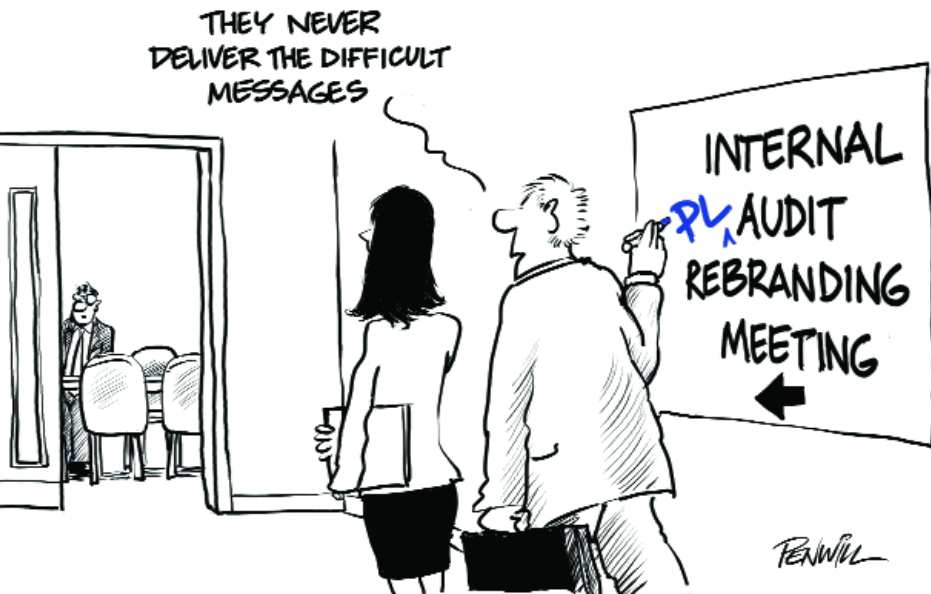


Differing Perspectives

*A survey of
Internal Audit Effectiveness*

A short summary



INDEPENDENT
AUDIT LIMITED



1. About this survey

What we looked at

Internal Audit is today a key part of the governance framework of any major organisation. As business becomes ever more complex and the risks faced more challenging, the demands on Internal Audit are also increasing: provide more assurance, add further value, become a business partner and remain independent.

When it comes to the effectiveness of Internal Audit, our work with Boards, Audit Committees and Internal Audit has often shown that the viewpoints of the three key stakeholders – the Head of Internal Audit, the Audit Committee Chair and the Executive to whom Internal Audit reports – can diverge, sometimes in crucial respects. So we thought it would be a good idea to investigate more thoroughly, by way of survey, how these perspectives differ.

What we asked

We explored three areas:

- how the three stakeholders assess Internal Audit effectiveness...
- what the most important objectives for Internal Audit are...
- what factors particularly shape the effectiveness of Internal Audit.

This summary outlines our findings. It is based on the responses from 80 key stakeholders* covering a total of 52 organisations, mostly large companies. We'd like to thank them all for taking part.

* The responses came from Audit Committee Chairs (22%), Executives (21%) and Heads of Internal Audit (57%)

2. Assessing effectiveness

Personal interactions

We started by asking about the importance of **personal interactions** between the Audit Committee Chair / Executive responsible for Internal Audit, and Internal Audit itself. The survey shows personal interaction, in its various forms, is the main factor shaping views of Internal Audit.

Not surprisingly, **presentations by the Head of Internal Audit** at Audit Committee or Executive meetings are regarded as very important by everyone: over four-fifths of respondents, whether Audit Committee Chairs, Executives or Heads of Internal Audit, think so.

More surprisingly, there is a big difference in views about the importance of **other contributions by the Head of Internal Audit** in formal meetings (i.e. when Internal Audit is not the agenda item being discussed). Two-thirds of Executives and Heads of Internal Audit see this as very important in shaping perceptions of Internal Audit. In contrast, only a third of Audit Committee Chairs do.

Without exception, all Executives say that **private meetings and review meetings** with the Head of Internal Audit are very important in shaping their view of effectiveness. Nearly as many (90%) Audit Committee Chairs think the same, but 22% of Heads of Internal Audit don't see these meetings with their key stakeholders that way.

Meetings with the other members of the Internal Audit team (at all levels) are not generally seen as very important by any of the stakeholders. A sizeable minority (about 40%) of Executives and Heads of Internal Audit, however, see some sort of interaction between Audit Committee Chairs / Executives and members of the Internal Audit leadership team as very important; but only half this proportion (22%) of Audit Committee Chairs think so.

Others' views

Also playing a major role in helping shape key stakeholders' views of Internal Audit's effectiveness is the **feedback** they get from others.

Not surprisingly, the views that count most come from the **Chief Executive, Finance Director** and **Audit Committee Chair**.

But there are big divergences in a few interesting areas:

- Most Audit Committee Chairs (89%) regard the **external auditors** as the most important source of views about the effectiveness of Internal Audit – more important, even, than the views of the Chief Executive or Finance Director. But only about half of Executives and a quarter of Heads of Internal Audit think the external auditors' views of Internal Audit are very important.
- A majority of Executives (59%) regard the views of **auditees** (for example, the management of a business unit being audited) as very important, but only 38% of Heads of Internal Audit agree. And relatively few Audit Committee Chairs (11%) think auditees' views are very important in helping them form a view of Internal Audit's effectiveness.

Perhaps surprisingly, given the importance placed nowadays on effective co-ordination in assurance, the views of **other assurance functions** don't count for much, being regarded as very important by about a fifth or less of each key stakeholder group.

Documents

We asked how important certain **documents** that key stakeholders see are, in helping form views of the effectiveness of Internal Audit.

Over 80% of Executives and Heads of Internal Audit say **summary reports** (for example, briefing papers for executive or audit committee meetings) are very important in shaping their views, but surprisingly only two-thirds of Audit Committee Chairs hold this view.

Similarly, we are surprised to see that as many as 44% of Audit Committee Chairs think that **individual audit reports** are important in shaping their views of Internal Audit's effectiveness.

Interestingly, almost four-fifths of Audit Committee Chairs say that **risk reports** – for example, produced by the business or a risk function rather than Internal Audit's own analysis of risks – are very important in forming their view of the effectiveness of Internal Audit. But only a third of Executives and Heads of Internal Audit think the same.

Despite much talk about assurance mapping, just less than half of Audit Committee Chairs and only about 30% of Executives and Heads of Internal Audit say that an **assurance map** is very important in shaping their views of Internal Audit effectiveness.

Measures and indicators

'Hard' measures (such as KPIs) are relatively unimportant in helping key stakeholders form a view of Internal Audit effectiveness in practice, in comparison to more subjective or 'softer' gauges of effectiveness such as impressions formed from personal interactions and views obtained from others.

But amongst the measures and indicators that are used, five are broadly seen as most useful and regarded as very important:

- summary **audit report ratings** and trends in ratings
- trend in and number of **high risk audit findings**
- **overdue management actions**
- current year **audit coverage**
- extent of **completion of audit plan**

Financial measures – such as such as losses from fraud or other irregularity, the cost of operational losses or “near misses”, the amount by which Internal Audit reduces external audit fees and the value of efficiency savings identified by Internal Audit – are largely not seen as very important indicators of Internal Audit effectiveness.

People measures – such as the number of people leaving Internal Audit and joining the business, or the number of people joining Internal Audit from the business – are also seldom seen as very important in helping form views of Internal Audit's effectiveness.

3. Objectives

It's important to know what your Internal Audit has been tasked with doing, in order to assess whether it is effective.

We asked our survey participants what are the primary objectives of their Internal Audit functions.

Not surprisingly, **assurance over financial controls** and **assurance over business (non-financial) controls** are regarded as the top two primary objectives. However, there is a difference in the way the stakeholders see the relative importance of these. All Audit Committee Chairs and all Executives regard assurance over financial controls as a primary objective – but only three-quarters of Heads of Audit hold the same view. Most Heads of Internal Audit and Executives (over 90% of each) regard assurance over business (non-financial) controls as being a primary objective, but less than three-quarters of Audit Committee Chairs agree.

Audit Committee Chairs (61%) and Executives (76%) regard **investigations** to be a primary objective of Internal Audit – but only just over a quarter of Heads of Internal Audit hold this view. Two-thirds of Heads of Internal Audit think that promoting an appropriate risk and **control culture** is a primary objective, but only half the Audit Committee Chairs and Executives hold this view.

There is a particularly noticeable divergence in views regarding Internal Audit's role in undertaking detailed **compliance checks** at sites and locations (such as across a store or branch network, or at third parties such as agents). Only 16% of Heads of Internal Audit see this as a primary objective, compared to a much larger proportion of Executives (41%) and Audit Committee Chairs (50%).

Similarly, half of the Audit Committee Chairs surveyed say that Internal Audit has a primary role in relation to **facilitating risk management**, in contrast to just under a third of Heads of Internal Audit and just under a fifth of Executives.

Is Internal Audit a **training ground** for future leaders of the business? A sizeable minority of Audit Committee Chairs (28%) and of Heads of Internal Audit (22%) think this is a primary objective of Internal Audit – but not one of the Executives do.



4. Drivers of effectiveness

An internal audit function with the right attributes and which operates in a constructive environment is more likely to achieve the objectives it has been set.

We asked which attributes and environmental factors – we call these ‘drivers’ – are transformational, such that further improvement or investment in these drivers could take Internal Audit from good to great.

Leadership of Internal Audit – having a Head of Internal Audit with the right skills and attributes – is regarded as a transformational driver of effectiveness. This is the top rated driver by Heads of Internal Audit (82% say it is transformational – surprisingly, not all do...) and by Executives (94%). Whilst 56% of Audit Committee Chairs see this as a transformational driver, they only regard this as fourth most important.

Audit Committee Chairs (78%) regard **management attitudes** towards controls and assurance as the foremost driver of Internal Audit’s effectiveness. About two-thirds of Executives and Heads of Internal Audit also believe management attitudes to be transformational.

Audit Committee support of Internal Audit is regarded as a transformational driver by about three-fifths of Audit Committee Chairs, Executives and Heads of Internal Audit. A similar proportion of all three stakeholders regard **communication and reporting** as capable of being transformational.

Two thirds of Heads of Internal Audit regard **audit team skills and experience** as being transformational, but this view is only held by half the Executives and by less than a third of Audit Committee Chairs.

Planning, execution, objectivity, the management of the internal audit function and the remit of work are widely regarded as foundation attributes, rather than as transformational.



5. A few good ideas

We thought it would be a good idea to ask people what they've done to transform their internal audit function: how they've taken it from good to great.

We had quite a few suggestions that you might expect: change the head of internal audit, improve the skills sets in the team and make better use of technology. We also had some innovative ideas put forward, that we've seen work well in practice.

Here are five ideas we particularly liked...

1. Formulating a three year strategy for Internal Audit to develop a longer term perspective beyond the annual plan ✓
2. Developing service level agreements (SLAs) between Internal Audit and management to get clarity and commitment ✓
3. CEO involvement, when necessary, in ensuring the timely closure of important issues and getting management buy-in ✓
4. Internal Audit taking ownership of a risk assurance map, providing clarity over sources and extent of assurance ✓
5. Embracing organisation-wide themed audits, rather than focusing on subsidiary- and entity-based audits ✓

You might like to try these ideas, if you haven't already.

6. Some things to think about

The findings from our survey made us think! We hope it will do the same for you.

Here are three questions to think about for starters...

1. *When the views of others shape your own view of Internal Audit's effectiveness, do you have a good basis for relying on them?*

For example: Audit Committee Chairs regard the views of the external auditors as very important when it comes to shaping their views of Internal Audit's effectiveness, but it's not always clear that external audit has detailed insight into the work of Internal Audit, or Internal Audit does enough to ensure the external auditors understand the full extent of their work and influence.

2. *Is there a common understanding of what Internal Audit is there to do, and is this effectively captured and communicated?*

For example: A large number of Audit Committee Chairs and Executives think undertaking detailed compliance checks at sites and locations as a primary objective of Internal Audit – but Heads of Internal Audit do not. Internal Audit's charter often is updated without much discussion or debate, and there may be a missed opportunity to ensure a common understanding of its role.

3. *Is there agreement as to where further investment of time and resource in relation to Internal Audit should be focused?*

For example: Internal Audit leadership is viewed as transformational by most Executives and Heads of Internal Audit, but only by half of Audit Committee Chairs. There are also differing views as to the importance of Internal Audit team skills. So, we'd ask whether the right focus is being given to developing Internal Audit's leadership and other skills.

7. How we can help

At Independent Audit, we are experts in governance – and experts in Internal Audit.

We give **advice and assurance** to Boards over the quality of their governance, risk management and audit functions. We've helped many of our clients – large and small, across a variety of sectors – ensure Internal Audit provides a solid foundation for effective governance and meets the needs of the business.

Our independent reviews of Internal Audit are **strategic and forward looking**. We look at how well Internal Audit does what it is meant to do, and what impact it has made. But we also consider how well placed it is to support the changing needs of the business, and how it fits with the rest of the risk management and control framework.

We're uniquely placed to look at Internal Audit from **differing perspectives** because of our team members' varied and relevant backgrounds. Does Internal Audit meet the needs of the Audit Committee? Is it doing something useful for the business? And are management and the Audit Committee providing the right kind of support for Internal Audit to enable it to be effective?

If external review isn't what you're looking for, then our easy to use web-based **self-assessment** service, *Thinking Board*, lets you stay in control but still get an external perspective.



8. Coming soon...

This paper summarises some of the key findings from our survey: Differing Perspectives of Internal Audit Effectiveness. A full report providing greater analysis and insight will be available later this year. If you'd like a copy of this, please let us know.



Contact

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