



Achieving Excellence in Assurance, Strategic Risk Insights, and More

Viewpoints From Financial Services Stakeholders

A CBOK Stakeholder Report

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Michael Thor

STAKEHOLDER STUDY FACTS

Survey participants	1,124
Interview participants	100+
IIA institute countries	23
Languages	13

STAKEHOLDER POSITIONS REPRESENTED

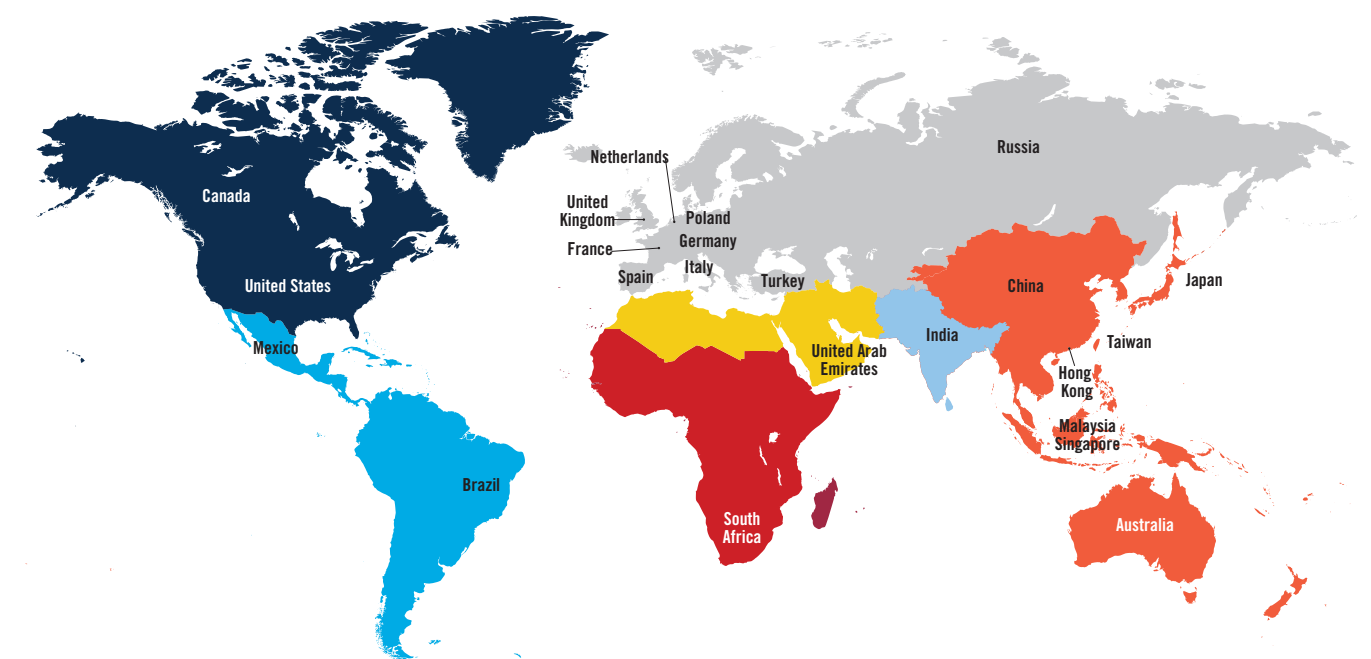
Board member	34%
Chief executive officer (CEO)	15%
Chief financial officer (CFO)	18%
Other C-suite	33%

About CBOK

The Global Internal Audit Common Body of Knowledge (CBOK) is the world's largest ongoing study of the internal audit profession. The current CBOK study has two major components: practitioner and stakeholder. The practitioner study encompasses reports that explore a variety of internal audit practices. To complement this information, the stakeholder study seeks out perspectives from stakeholders about internal audit performance. Surveys, interviews, and data analysis for the stakeholder project were conducted by Protiviti in partnership with IIA institutes around the world. Stakeholder reports focus on identifying leading practices that can improve internal audit effectiveness.

CBOK reports are available free of charge thanks to generous contributions and support from individuals, organizations, IIA chapters, and IIA institutes worldwide. Practitioner and stakeholder reports are available for download at the CBOK Resource Exchange (www.theiia.org/goto/CBOK). Stakeholder reports are also available at the Protiviti website (www.protiviti.com).

CBOK 2015 Stakeholder Study: Participants from 23 Countries



Note: Twenty-three countries participated with The IIA Research Foundation and Protiviti to distribute surveys and interview questionnaires to stakeholders in their region from July 2015 to February 2016. Partially completed surveys were included in analysis as long as demographic questions were complete. Questions in CBOK reports are referenced as Q1, Q2, and so on. The colors on the map show the seven global regions (based on World Bank categories) used for CBOK studies.

Executive Summary

Global macroeconomic uncertainty and rock-bottom interest rates, soaring regulatory expectations, cybersecurity threats and attacks, legacy information technology (IT) systems, Fintech, blockchain, and other disruptive innovations are all examples of the staggering collection of market and regulatory challenges that confront the financial services industry (FSI), making it the most demanding sector in which internal auditors operate.

Amid the industry's growing macroeconomic, regulatory, procedural, and technological complexity, internal audit within FSI must fulfill its core mission of delivering assurance excellence. Yet, internal auditors must do more. Effective assurance alone no longer guarantees success. This is an important message conveyed by FSI participants in the 2015 Global Internal Audit Common Body of Knowledge (CBOK) Stakeholder Survey.

The results of this global survey of stakeholders—specifically, the results from the responses of executives and board members who work closely with internal auditors—reveal best practices that internal auditors in FSI should consider in their quest to continually improve performance and deliver more value to their organizations. Among the key findings:

- Internal audit reporting structure, the chief audit executive's (CAE's) relationships with the boards and the executive teams, and the entire function's communication skill and style represent key success factors.
- Assurance is paramount. The consultative, value-added work that stakeholders clearly want auditors to deliver cannot detract from assurance.
- Assurance work is most valuable when it is aligned with the strategic risks of the organization and provides credible challenges to the effectiveness of risk management activities within the organization.

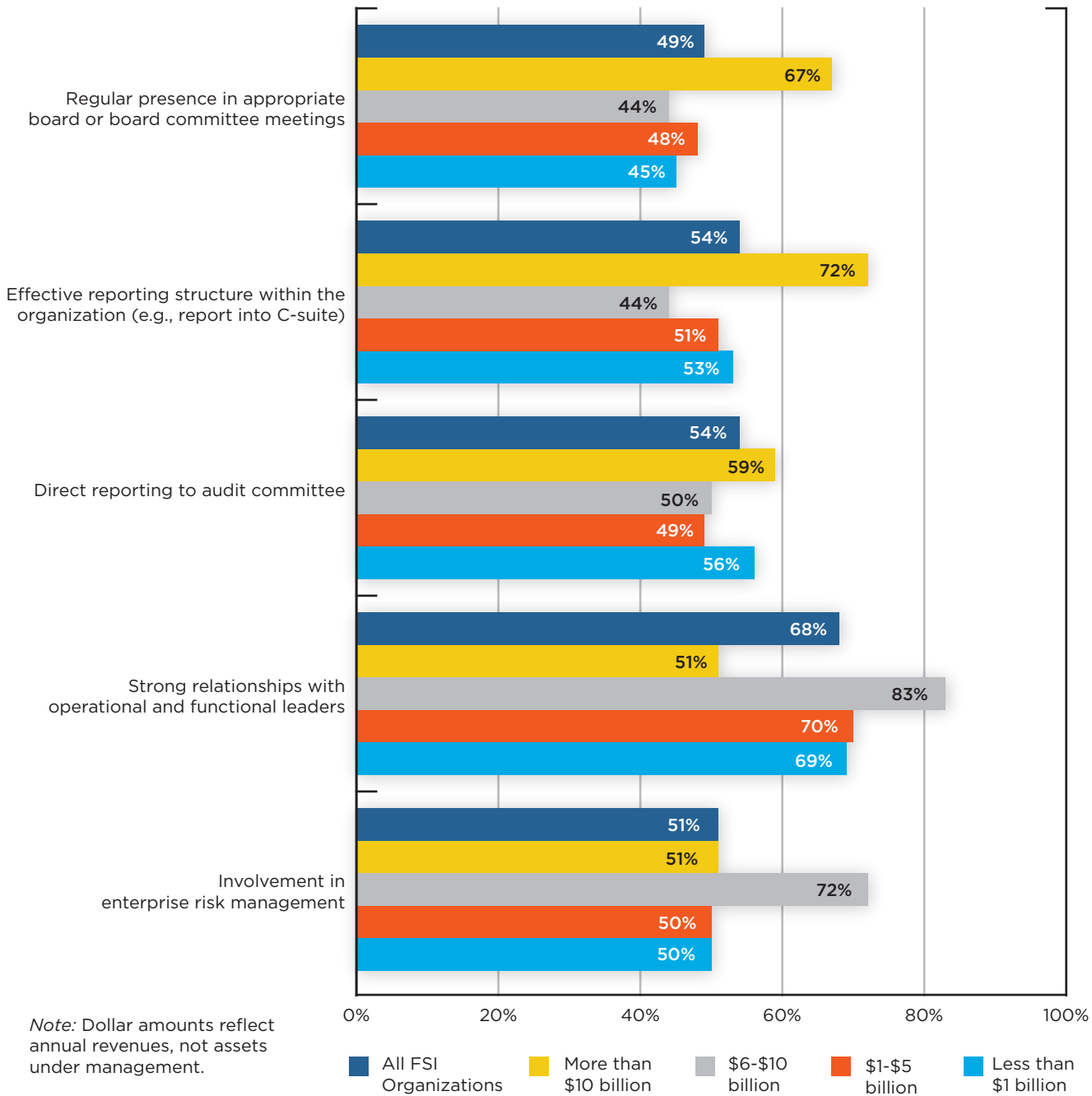
- CAEs and internal auditors should convey both good and bad news while exerting their influence to focus attention (at the board level and throughout the organization) on specific risks. CAEs also should possess the authority necessary to elevate and communicate strategic issues quickly to executive management and the board.
- Stakeholders expect internal audit to assess governance effectiveness and to monitor the values and behaviors that influence the organization's risk culture.
- Stakeholders believe that internal audit should take on a more active role in assessing and evaluating the organization's strategic risks and emerging risks.

Reporting Structure, Stakeholder Relationships, and Effective Communication Are Keys to Success

It comes as no surprise that CAEs face competing demands in their organizations daily. They can prioritize these demands and establish effective strategies to address them by working with management. Within the largest FSI organizations, stakeholders identify “a regular presence in appropriate board and board committee meetings” and “effective reporting structure within the organization” as highly effective strategies for addressing competing demands. Within smaller FSI companies, stakeholders place greater emphasis on the CAE's “strong relationships with operational and functional leaders” and “involvement in enterprise risk management” (see **exhibit 1**).

These findings make sense. Auditing issues within larger, more complex organizations tend to require CAEs to engage in more frequent and detailed board-level discussions (requiring more “air cover”), while audit executives in smaller organizations spend more time on the ground addressing root causes.

Exhibit 1 Effective Strategies for CAEs to Address Competing Demands in FSI Organizations



Note: Q9: What have you found to be the three most effective strategies for a chief audit executive to employ in order to prioritize and address competing demands in the organization? *n* = 268.

A NOTE REGARDING REGULATORS

While the CBOK 2015 Stakeholder Survey did not include input from financial services regulators, CAEs should apply the same recommendations of building relationships and improving communications with their respective regulators as they do with other key stakeholders in the organization. This is especially important if the financial services organization is large enough to have resident or specifically assigned regulators or examiners.

According to stakeholders, the CAE reporting line, ideally directly to the audit committee or another board committee, marks a foundational element of internal audit success. Of note, another success factor is the internal audit function's conformance with The IIA's *International Standards for the Professional Practice of Internal Auditing*. In the CBOK stakeholder survey, 95% of the respondents who are familiar with the *Standards* (two-thirds of all participants) see value in internal auditors adhering to the *Standards*.

When it comes to establishing and strengthening relationships with the board and with operational and functional leaders, communication is crucial. Leading CAEs operate as “great communicators” in their organizations, adeptly conveying both good and bad news, while helping the board focus on specific risks and aiding organizational partners in fixing problems that demand attention. The CAE's communication style and effectiveness also influences the behavior of individual internal auditors and marks key determinants of the function's overall performance and success. The survey results indicate that internal audit, as a whole, communicates effectively with stakeholders, but there is room for improvement (see **exhibit 2**).

Of note, the changing regulatory landscape has increased the focus and heightened the expectations for financial institutions around risk management and compliance risk management. According to The IIA, the Three Lines of Defense model provides a simple and effective way to enhance communications on risk management and

controls by clarifying essential roles and duties. It provides a fresh look at operations, helping to ensure the ongoing success of risk management initiatives, and it is appropriate for any organization, regardless of size or complexity. Each line of defense plays a distinct role in the organization's wider governance framework.*

The Three Lines of Defense model is accepted as a best practice by federal banking regulators and the Basel Committee on Banking Supervision. Therefore, regulators encourage use of the Three Lines of Defense model in regulated financial institutions. Internal audit plays a major role in coordinating efforts, especially within financial institutions. Under the *Standards*, CAEs are specifically required to “share information and coordinate activities with other internal and external providers of assurance and consulting services to ensure proper coverage and minimize duplication of efforts.”** This is an important aspect of internal audit's maintenance of strong stakeholder relationships.

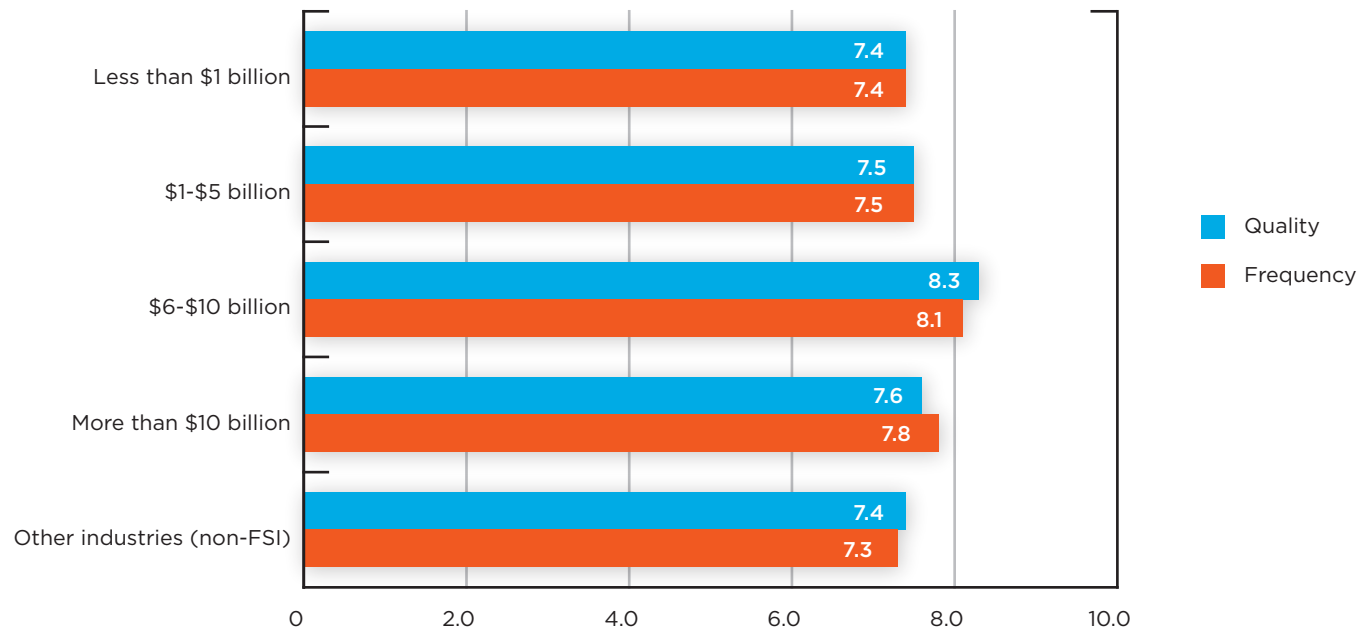
ACTION ITEMS FOR CAEs AND INTERNAL AUDITORS

- ☑ Cultivate a better understanding of internal audit's value through effective communications with management and the board.
- ☑ Strive to have the CAE report directly to the audit committee; interact with directors in relevant, nontraditional board settings; and seek ways, in collaboration with the audit committee, to strengthen the CAE's escalatory authority.

* *The Three Lines of Defense in Effective Risk Management and Control*, The Institute of Internal Auditors, Jan. 2013: <https://na.theiia.org/standards-guidance/Public%20Documents/> (accessed September 2, 2016).

** The Institute of Internal Auditors International Professional Practices Framework Practice Advisory 2050-3, 2013.

Exhibit 2 Internal Audit Effectiveness in Communicating with FSI Stakeholders



Note: Dollar amounts reflect annual revenues, not assets under management.

Note: Q25 and Q26: How would you rate internal audit's level of communication with you in terms of quality and frequency? (10-point scale, where "10" represents excellent communication and "1" represents poor communication). (FSI respondents). $n = 234$.

Providing Leading-Class Assurance is Expected, but Stakeholders Want More

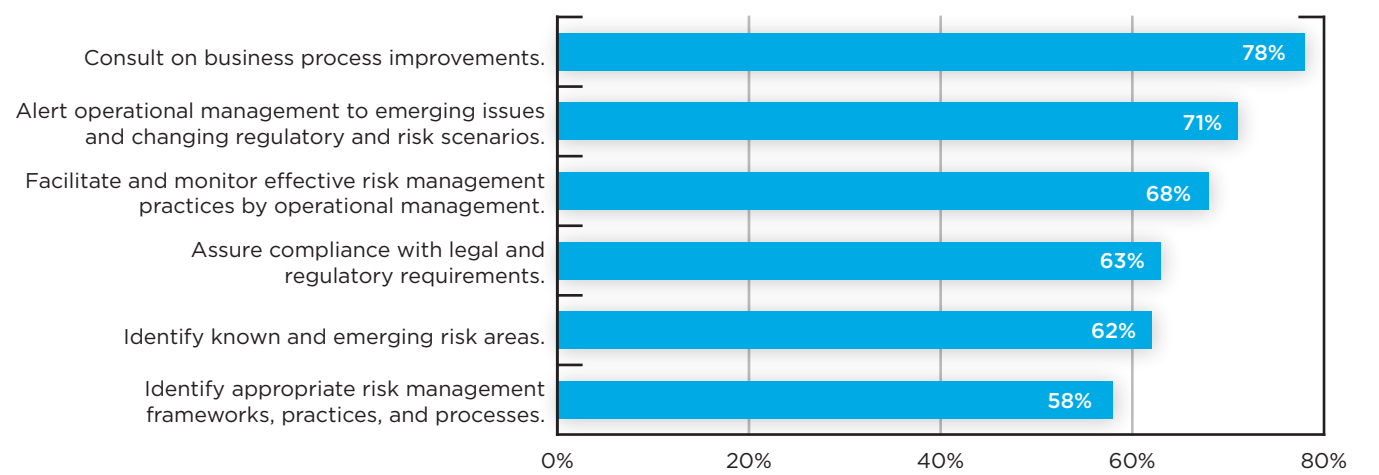
Without question, internal audit stakeholders expect the audit function to provide top-notch assurance. This requires that internal auditors demonstrate to stakeholders that risks related to financial, operating, and compliance objectives are managed properly. Providing excellent assurance calls for a clear articulation of the value a risk-based audit plan delivers, the optimal deployment of auditing technology to maximize audit efficiency and effectiveness, the escalation authority—and proactive use of this authority—to alert executives and the board of important issues on a timely basis, and more.

In the arduous realm of internal auditing in FSI, however, leading-class assurance qualifies as table stakes. Stakeholders also expect, and are particularly emphatic, that internal audit delivers value through advisory and

consulting work. When asked to identify where internal auditors should focus their efforts beyond assurance, stakeholders placed the greatest emphasis on a number of risk oversight, risk management, and procedural and consulting/advisory areas, including (see **exhibit 3**):

- Consult on business process improvements.
- Alert operational management to emerging issues and changing regulatory and risk scenarios.
- Facilitate and monitor effective risk management practices by operational management.
- Assure compliance with legal and regulatory requirements.
- Identify known and emerging risk areas.
- Identify appropriate risk management frameworks, practices, and processes.

Exhibit 3 Areas for Internal Audit to Address Beyond Assurance in FSI Organizations



Note: Q10 to Q13: Which of the following areas should, beyond assurance, be in scope for internal audit? (FSI respondents). n = 242.

“In order to add value, you need someone who is part of the organization, knows what is going on, and has an excellent personal network. Co-sourcing is a very good means of adding specific skills, knowledge, and experience.”

—Chief Financial Officer,
Netherlands, Finance and Insurance Industry

The added-value work should not detract from internal audit’s assurance work. Often, internal audit functions are challenged to maintain the right balancing act between assurance and other activities. In some instances, they may not possess the capacity to satisfy their stakeholders’ expectations to focus on areas beyond assurance work. On this count, co-sourcing can help. Nearly half of the survey respondents (44%) indicated that their internal audit shops co-source at least some activities; the majority does so to address a lack of personnel and capacity.

In other cases, stakeholders may need help rethinking the concept of control that underpins assurance work. Leading FSI internal audit functions tend to frame

“There is a clear expectation that internal auditors would not audit their own work. It is important to have internal audit as an observer to get information up front. Internal audit can then comment on risk without jeopardizing independence.”

—Chief Financial Officer,
Canada, Finance and Insurance Industry

controls in terms that engage CEOs and other executives as valuable enablers of strategy and policy and of a consistent customer experience. Seen and managed through this lens, controls tend to take on an enhanced perception throughout the organization. This can clarify the true value of internal audit’s assurance work while illuminating how and where internal auditors can deliver that value beyond assurance.

Additionally, while it is important for internal audit to lend its expertise to line-of-business leaders in FSIs, they need to proceed cautiously, given the regulatory environment in the industry. Such consulting approaches a fine line that regulators tend to review closely.

ACTION ITEMS FOR CAEs AND INTERNAL AUDITORS

- ✓ Prioritize internal audit activities to reflect assurance as indispensable.
- ✓ Clearly communicate the value of assurance, and frame the value of controls in terms of how they support strategic objectives.
- ✓ Expand the function's focus to include consulting on business process improvements, alerting operational management to emerging issues and changing regulatory and risk scenarios, and facilitating and monitoring effective risk management practices by operational management.

- Demonstrating sufficient knowledge of key IT risks and controls in performing audit engagements
- Demonstrating sufficient knowledge of fraud and corruption to identify red flags, which indicate possible fraud or corruption when planning and conducting audit engagements

"Internal audit's primary responsibility is based around providing assurance on the risks and controls for operational processes and IT systems. Business requests are accepted, however, only if they do not compromise internal audit's plan or independence."

—Chief Financial Officer,
Netherlands, Finance and Insurance Industry

Five Assurance Areas to Improve

When asked to describe the extent to which they agree or disagree with statements of internal audit's abilities in different assurance activities, stakeholders agreed, and often strongly agreed, with a number of statements. For example, **exhibit 4** indicates that a strong majority of stakeholders agree that in their organizations, internal audit establishes audit plans to assess areas of topics that are significant and highly relevant to the organization and consistent with organizational goals.

There are five areas, however, in which there are lower levels of agreement among stakeholders as to the effectiveness of internal auditors, suggesting areas of needed improvement for FSI internal audit groups. Those areas are:

- Effectively validating that executive management promotes appropriate ethics and values within the organization
- Communicating which risks or activities of the organization are not covered by the internal audit plan
- Assessing the adequacy and effectiveness of governance

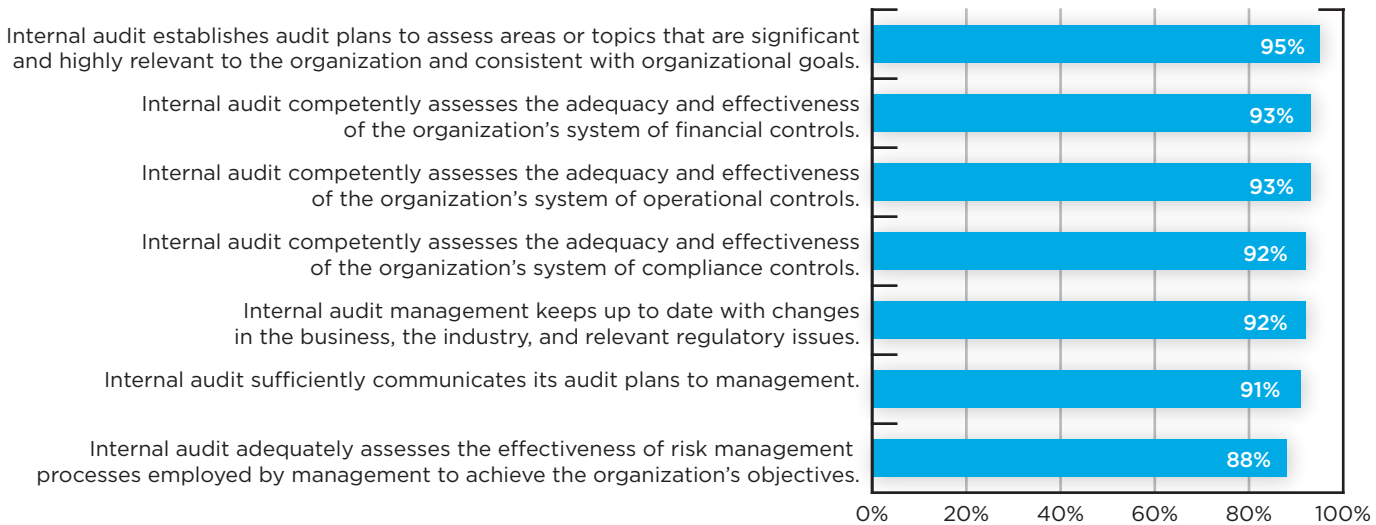
ACTION ITEMS FOR CAEs AND INTERNAL AUDITORS

- ✓ Clarify audit plans to show how strategic risks are covered by the audit plans, and which risks are not covered.
- ✓ Understand risk culture within the organization, monitor signs of a deteriorating risk culture, and remain vigilant with respect to fraud and corruption.
- ✓ Strengthen knowledge of IT risks and controls and keep current on emerging technology.

Where Internal Audit Can Deliver More Value

Stakeholders were asked to assess internal audit's performance in a number of activities beyond assurance. Their responses suggest that providing assistance in managing risk represents a strength for internal audit, as does serving as an educator and advising on business process improvements.

Exhibit 4 Attributes of Internal Audit as Assessed by FSI Stakeholders



Note: Q18: Please provide a response to each of the following statements according to the following scale: Strongly Agree, Agree, Disagree, Strongly Disagree, Don't Know. Percentage shown for those that indicated Strongly Agree and Agree. (FSI respondents). *n* = 244.

However, other areas—including among them are conducting data analysis for management, acting as a change agent, and facilitating communication among different departments—were rated comparatively lower. Overall, it is clear that internal audit functions are delivering value more effectively in certain areas, but there is room for improvement in many activities that fall beyond assurance.

Stakeholders in larger FSI organizations tend to rate internal audit's performance in all these areas more strongly, which suggests that higher levels of resources and data analysis tools and technologies may help elevate performance.

There are a number of ways that internal auditors can improve their more consultative activities. For example, internal audit can ensure its reports shine a light on issues that business units are not aware of, rather than focus too much analysis on what is self-evident. Ongoing collaboration with stakeholders on the business-improvement and efficiency opportunities internal auditors sniff out during assurance work can also help.

Additionally, by consistently aligning assurance activities with strategy and key enterprise risks, internal auditors and stakeholders are more likely to identify new ways that internal audit can deliver value beyond assurance. While there are these and other opportunities to contribute further value, internal auditors must also be mindful of the regulatory environment in FSI and understand how regulators view consulting activities from the third line of defense.

Internal audit functions that perform well across a range of value-added activities tend to hire and develop internal auditors who think critically and broadly across the business. More specifically, these auditors amass a deep knowledge of the organization and FSI as a whole, and periodically look forward from a strategic perspective to evaluate how the business will need to evolve in response to current market conditions, competitive threats, and regulatory pressures. These internal auditors also tend to cultivate valuable external networks of experts and peers that they tap into for insight and ideas.

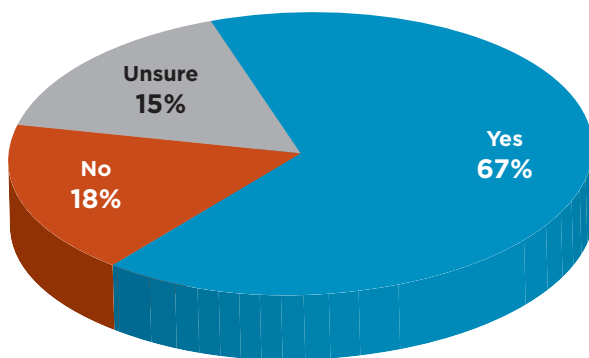
ACTION ITEMS FOR CAEs AND INTERNAL AUDITORS

- ✓ Establish effective relationships with business partners, while facilitating risk-based discussions and serving as a change agent among all business units and independent functions.
- ✓ Leverage technology-enabled auditing to provide more analytical insights into the business and create more time for consultative work.

Opportunities to Deliver More Strategic Risk Assessments and Evaluation

More than 65% of board members and executives in FSI believe internal audit should take on a more active role in assessing and evaluating the organization's strategic risks (see **exhibit 5**). This is a mandate for CAEs and internal auditors to think more strategically when evaluating risks and ensuring that their audit plans are sufficiently risk-based.

Exhibit 5 Internal Audit's Active Role in the Organization's Strategic Risks



Note: Q16: Do you believe internal audit should have a more active role in connection with assessing and evaluating the organization's strategic risks? (FSI respondents). $n = 166$.

When asked how internal audit can enhance its role in assessing and responding to strategic risks facing the organization, the top two responses were: “focus on strategic risks as well as operational, financial, and compliance risks during audit projects” and “periodically evaluate and communicate key risks to the board and executive management.” Stakeholders from the largest FSI companies also pointed to internal audit's evaluation of the execution of strategic initiatives as a valuable way to strengthen the function's involvement in assessing and evaluating strategic risks (see **exhibit 6**).

“Business is evolving, and the current CAE should continue to anticipate key risks and issues.”

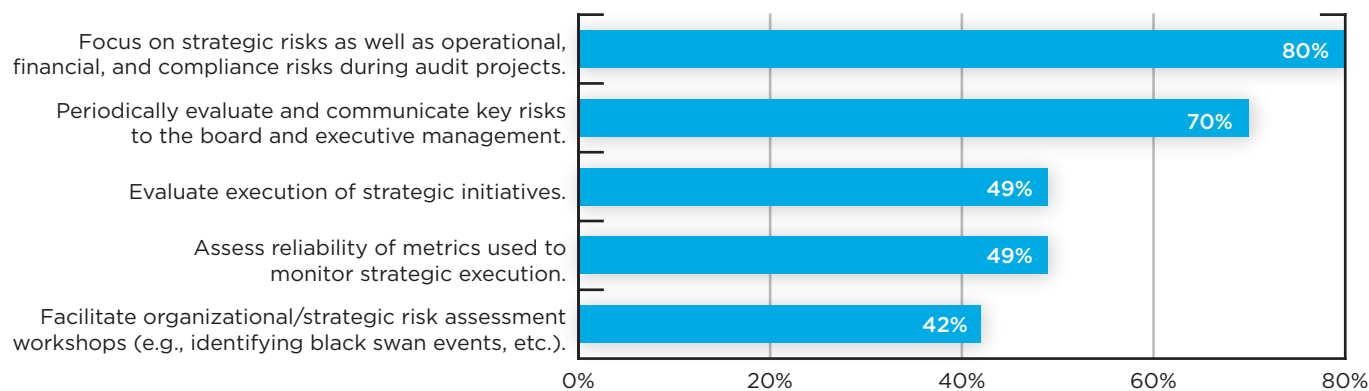
—Board Member/Audit Committee Member,
Canada, Finance and Insurance Industry

By understanding the organization's business objectives and strategy, identifying risks to the organization's success in achieving its objectives, and executing its strategy, leading internal audit functions enhance their value proposition to stakeholders. This enables auditors to meet more frequently with key stakeholders on the board and throughout the business, while also providing internal audit's perspectives on risks, including emerging threats, to executing the strategy. The CAE's involvement in strategic planning and decision-making initiatives also helps the function as a whole align its work with strategic objectives and strategic risks.

ACTION ITEMS FOR CAEs AND INTERNAL AUDITORS

- ✓ CAEs should participate in strategy-setting sessions while maintaining independence and homing in on the context of decisions. They should continually share these insights with the internal audit team to help them think more strategically when analyzing risks and framing audit plans, and focus on the alignment of the work back to the strategic risks.

Exhibit 6 Avenues for Internal Audit to Improve Its Role in Responding to Strategic Risks



Note: Q17: Please designate which of the following are avenues for internal audit to improve its role in assessing/responding to strategic risks facing your organization. (FSI respondents). n = 553.

- ☑ Facilitate the risk appetite dialogue at the highest levels of the organization and suggest updates to the company’s risk profile to reflect changing conditions.
- ☑ Identify and anticipate barriers, including emerging risks, to the successful execution of the strategy.

Conclusion

The expectations of executive management and the board of directors concerning the internal audit function continue to evolve. This is hardly surprising, given the long list of dynamic challenges FSI confronts. As a result, leading CAEs continuously upgrade their function’s capabilities to keep pace with rising expectations. The results of the CBOK 2015 stakeholder survey provide a beacon for the internal audit function’s journey to excellence. The findings indicate that board members and executive management want their CAEs and internal audit groups to think more broadly and strategically, move beyond assurance to provide value-added consulting and advisory services, and continue to deliver on expectations.

About the Authors

Vernon H. Stafford, Jr., NBE, is the executive vice president and chief audit executive of First Horizon National Corporation. He is responsible for corporate internal audit and credit risk assurance. Prior to joining First Horizon in June 2013, he served for more than 30 years as a bank examiner with the OCC. Stafford is a commissioned national bank examiner, and from 2006 until 2011, he held the position as the examiner-in-charge at First Tennessee Bank. He is a graduate of Roger Williams College, where he earned a BS degree in accounting.

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