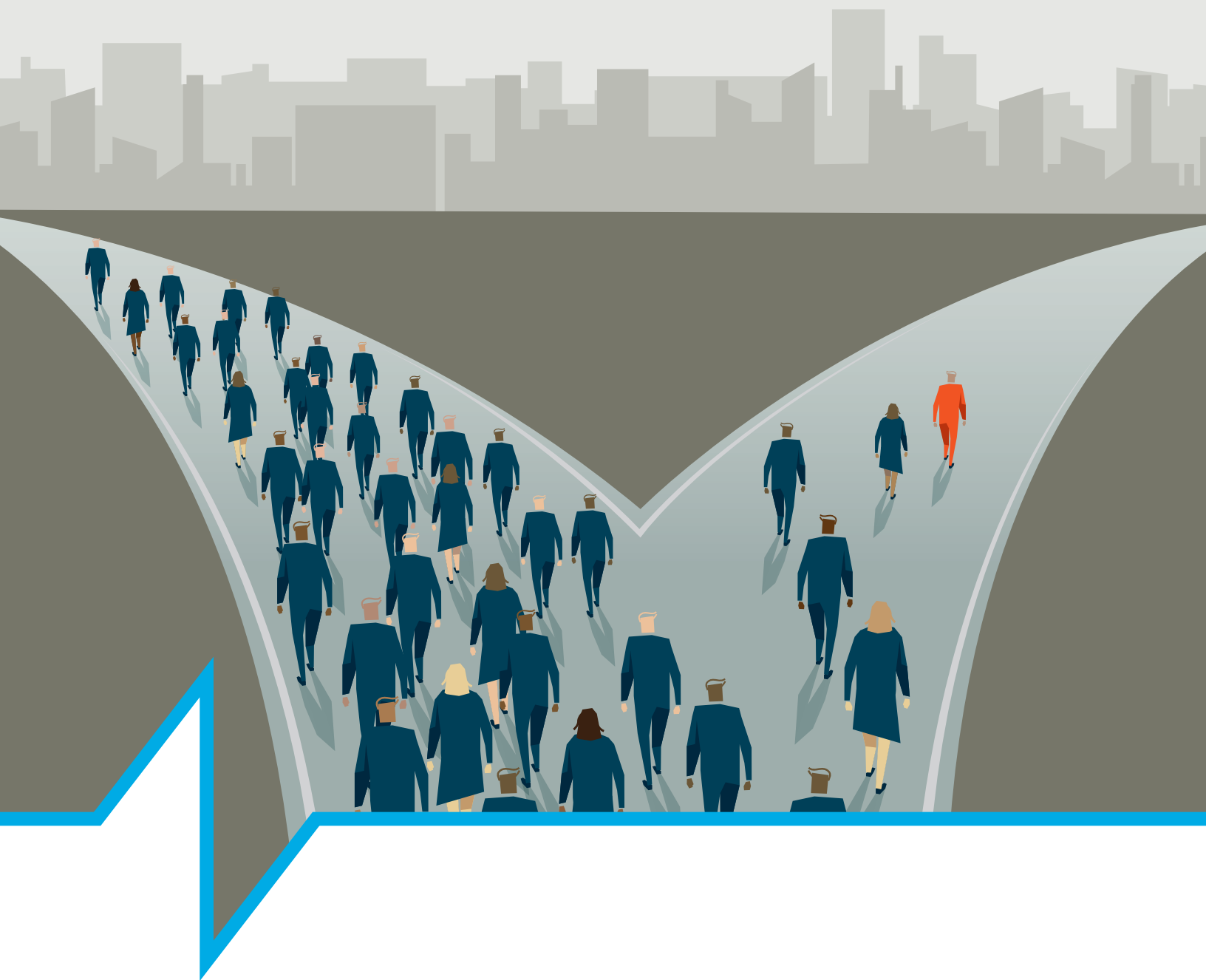


STRONG FOUNDATIONS

A Pulse of Internal Audit Supplemental Report



AUDIT EXECUTIVE
— C E N T E R —

About the Pulse of Internal Audit

Number of Responses

CAEs	460
Director/senior managers	78
Total	538

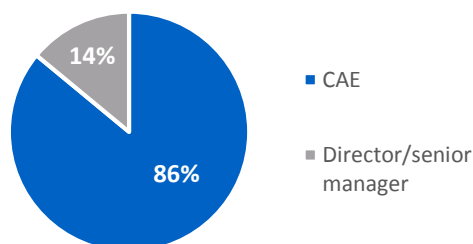
The IIA's Audit Executive Center® (AEC®) has gathered insight from leaders in the profession through the annual Pulse of Internal Audit survey since 2009. Each survey collects information about both established and emerging issues that are important to the profession as well as information about internal audit management (such as areas of focus, staff, and budget levels).

The 2017 North American Pulse of Internal Audit survey (Pulse) was conducted online from Oct. 20, 2016, to Nov. 11, 2016, with survey invitations distributed through the AEC, The IIA, and social media. The IIA collected data from 538 respondents, including 460 CAEs and 78 director/senior managers. In Pulse reports, CAEs and director/senior managers are collectively referred to as CAEs.

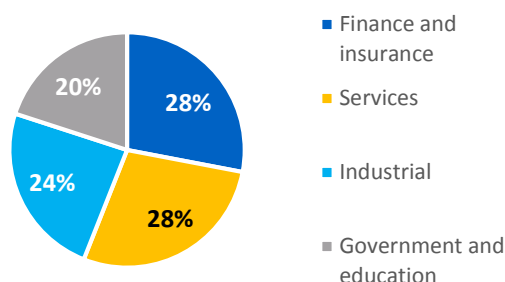
The survey results are analyzed and presented in multiple reports of which this is one. Complimentary high-level reports are made available to the public through The IIA's Pulse of Internal Audit resource page (visit www.theiia.org/pulse). More in-depth reports for internal audit management are available exclusively to members of the AEC. For more information about joining the AEC, visit www.theiia.org/aec.

RESPONDENT DEMOGRAPHICS

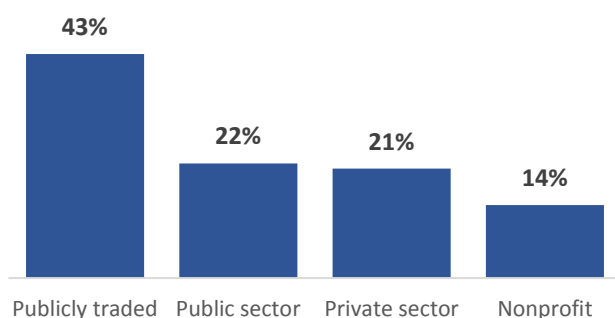
Internal Audit Position



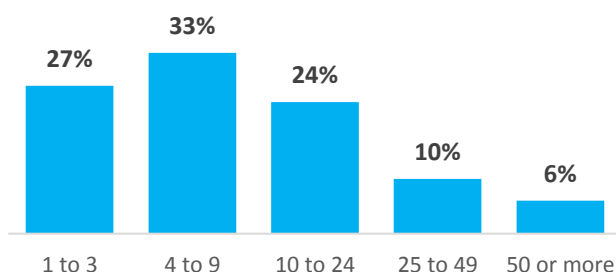
Industry Groupings*



Organization Type



Internal Audit Function Size (FTEs)



*Industry groupings were defined as follows: Industrial — manufacturing; construction; utilities; mining, quarrying, and oil and gas extraction; transportation and warehousing; waste management/remediation services. Services — health care; retail trade; real estate; accommodation and food; wholesale trade; entertainment; information; professional; agriculture. Government and education — public administration and educational services. Finance and insurance — financial institutions, insurance, asset management, broker-dealers.

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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/aec.

DISCLAIMER

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.

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NOTE TO THE READER

Italicized text signifies exact language from a component of The IIA's International Professional Practices Framework® (IPPF®).

INTERNAL AUDIT ACTIVITY

A department, division, team of consultants, or other practitioner(s) that provides independent, objective assurance and consulting services designed to add value and improve an organization's operations. The internal audit activity helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of governance, risk management, and control processes.

Introduction

Successful internal audit activities are built on a strong foundation — a foundation sturdy enough to withstand increased pressures from internal and external stakeholders, a turbulent geopolitical landscape, and evolving business practices.

Unfortunately, sometimes weaknesses in a foundation are not apparent until the foundation is stressed, and then it is too late — the foundation crumbles. When the foundation crumbles, it becomes more difficult for internal audit to provide valuable services to the organization.

This Pulse report is intended for chief audit executives (CAEs) who are building new internal audit activities, as well as CAEs who want to examine the structural soundness of established internal audit activities.

Section 1: The Cornerstones of a Strong Foundation

The cornerstones of a strong internal audit foundation are:

- Resources.
- Competence.
- Structure.
- The IIA's *International Standards for the Professional Practice of Internal Auditing*.¹

Internal audit's resource level, competence, and structure should be aligned with organizational strategy. However, all internal audit activities — regardless of size, industry, or type (publicly traded, public sector, privately held, or nonprofit) — should follow the *Standards*.

RESOURCES

Primary internal audit resources include staffing and budget.

STAFFING

*The CAE must ensure that internal audit resources are appropriate in terms of knowledge, skills, and other competencies; sufficient, with regard to quantity; and effectively deployed, to achieve the approved plan.*²

Across all types of organizations, the majority (59 percent) of internal audit activities are staffed with fewer than 10 full-time equivalents (FTEs). Larger audit activities are most commonly seen among financial services and publicly traded organizations, where one in five audit activities have 25 or more FTEs (Appendix, Exhibit A).

However, FTEs are not the only avenue for ensuring that resources are appropriate, sufficient, or effectively deployed. *If the quantity of resources is insufficient to cover the planned engagements efficiently and effectively, the CAE may hire additional staff, cosource or outsource engagements, use one or more guest auditors, or develop a rotational audit program.*³

STANDARD

According to the Standards: A standard is a professional pronouncement promulgated by the International Internal Audit Standards Board that delineates the requirements for performing a broad range of internal audit activities and for evaluating internal audit performance.

APPLYING THE STANDARDS

According to the IPPF: Implementation Guides (and formerly Practice Advisories) assist internal auditors in applying the Standards. They collectively address internal auditing's approach, methodologies, and consideration, but do not detail processes or procedures.

PROFICIENCY

Proficiency: Proficiency is a collective term that refers to the knowledge, skills, and other competencies required of internal auditors to effectively carry out their professional responsibilities. It encompasses consideration of current activities, trends, and emerging issues to enable relevant advice and recommendations. Internal auditors are encouraged to demonstrate their proficiency by obtaining appropriate professional certifications and qualifications, such as the Certified Internal Auditor designation and other designations offered by The Institute of Internal Auditors and other appropriate professional organizations.

BUDGET

Staffing and budget go hand-in-hand. And while compensation is likely to account for the largest share of internal audit's budget, other budget considerations include training, technology (such as data analytics tools), and travel. In 2016, across all types of organizations, more internal audit department budgets increased than decreased (Appendix, Exhibit B).

In managing resources, CAEs should provide the rationale for requested staffing and budget, and tie the resources to the audit plan and the audit plan to the risks and objectives of the organization. When developing the audit plan, CAEs should be cautious not to allow resource limitations or the current available skills and expertise to drive the plan. Audit plans should be driven by the organization's objectives and related risks, and the CAE should seek out the necessary resources to complete the plan. If fresh resources cannot be obtained, CAEs should report the limitation to the audit committee.

According to IIA President and CEO Richard F. Chambers, CAEs should take a two-pronged approach to protect internal audit resource levels. On a continuous basis, CAEs should examine the efficiency and effectiveness of the internal audit operation itself, and communicate to management and the board the value that internal audit brings to the organization.⁴

If the CAE has a direct functional reporting relationship with the board, then the board assumes responsibility for approving the internal audit charter, internal audit plan, internal audit budget and resource plan, evaluation and compensation of the CAE, and appointment and removal of the CAE.⁵

COMPETENCE

The *Standards* emphasize the importance of competence. *Internal auditors must possess the knowledge, skills, and other competencies needed to perform their individual responsibilities. The internal audit activity collectively must possess or obtain the knowledge, skills, and other competencies needed to perform its responsibilities.⁶*

An overview of 10 core competencies needed to support the success of the internal audit activity can be found in The IIA's Global Internal Audit Competency Framework (Exhibit 1).

EXHIBIT 1: GLOBAL INTERNAL AUDIT COMPETENCY FRAMEWORK



Source: The IIA's Global Internal Audit Competency Framework, available at www.theiia.org. ©2013 Institute of Internal Auditors, Inc.

TRAINING

Internal auditors must enhance their knowledge, skills, and other competencies through continuing professional development.⁷ Opportunities for professional development include participating in conferences, seminars, training programs, online courses and webinars, self-study programs, or classroom courses; conducting research projects; volunteering with professional organizations; and pursuing professional certifications such as The IIA's Certified Internal Auditor® (CIA®).⁸

According to the 2017 North American Pulse of Internal Audit report, the majority of CAEs (73 percent) report that they annually require 40 or more hours of external training for staff members, and most commonly provide training opportunities in the form of conferences, in-house training, and on-demand courses (Appendix, Exhibit C).

AUDIT SKILLS

2017 Pulse respondents indicate that the most essential skills for internal auditors are:

- Analytical/critical thinking.
- Communication.
- Understanding professional ethics.

SUPPLEMENTAL GUIDANCE

According to the IPPF: Supplemental Guidance, including Practice Guides, provides detailed guidance for conducting internal audit activities. These include topical areas, sector-specific issues, as well as processes and procedures, tools and techniques, programs, step-by-step approaches, and examples of deliverables.

DEMONSTRATING COMPETENCE

A Certified Internal Auditor® (CIA®) demonstrates current knowledge of internal audit practices and understanding of internal audit issues, risks, and remedies. The three-part exam covers:

- Mandatory guidance, internal control and risk concepts, tools and techniques.
- Managing the internal audit function.
- Governance and business ethics, risk management, and organizational structure.

Learn more at www.theiia.org/certification/cia-certification.

REPORTING LINES

Functional reporting refers to oversight of the responsibilities of the internal audit activity, including approval of the internal audit charter, the audit plan, evaluation of the CAE, and compensation for the CAE.

Administrative reporting refers to oversight of day-to-day matters, expense approval, human resource administration, communication, and internal policies and procedures.

THE “BOARD”

Many auditors, particularly in the public sector, believe that some portions of the *Standards* don’t apply because “board” refers to board of directors, which commonly exists in the private sector. In fact, the *Standards* define “board” as the highest level of governing body charged with the responsibility to direct and/or oversee the organization’s activities and hold senior management accountable.

- Understanding the internal audit process.
- Persuasion and collaboration.

In addition to training, CAEs can ensure that their internal audit activities collectively possess these skills through recruiting and other talent management efforts. The IIA Practice Guide “Talent Management: Recruiting, Developing, Motivating, and Retaining Great Team Members” provides CAEs and internal audit managers with guidance on how training and other aspects of talent management can enable internal audit to drive success in a changing world.

IPPF guidance related to staffing resources includes:

- Standard 1200: Proficiency and Due Professional Care.
- Standard 1210: Proficiency.
- Standard 1220: Due Professional Care.
- Standard 1230: Continuing Professional Development.
- Implementation Guides 1200, 1210, 1220, and 1230.
- Practice Guide: Talent Management.

STRUCTURE

Sufficient, competent internal audit resources will work more effectively and efficiently when supported by organizational structures (reporting lines) that minimize internal audit’s risk of conflicts of interest while enhancing its stature and authority. IIA Standard 1110: Organizational Independence states, in part, that *the chief audit executive must report to a level within the organization that allows the internal audit activity to fulfill its responsibilities*. Implementation Guide 1110 further explains that ideally, the CAE has a functional reporting line to the board — *this provides the CAE with direct board access for sensitive matters and enables sufficient organizational status. It ensures that the CAE has unrestricted access to the board, typically the highest level of governance in the organization ... Generally, the CAE also has an administrative reporting line to senior management, which further enables the requisite stature and authority of internal audit to fulfill responsibilities*.

According to Pulse respondents, CAEs do overwhelmingly report functionally to the board (88 percent), and administratively to a member of senior management (75 percent) (Appendix, Exhibit D).

THE INTERNATIONAL STANDARDS FOR THE PROFESSIONAL PRACTICE OF INTERNAL AUDITING

It is beyond the scope of this article to discuss each of the standards. However, in building a strong internal audit foundation, it is very important to understand independence and objectivity.

INDEPENDENCE AND OBJECTIVITY

Independence and objectivity are attributes that are fundamental to the professional practice of internal auditing. Independence pertains to the internal audit function, while objectivity pertains to the individual internal auditor.

Standard 1100: Independence and Objectivity states that *the internal audit activity must be independent, and internal auditors must be objective in performing their work*. As stated earlier, Standard 1110 states that *the CAE must report to a level within the organization that allows the internal audit activity to fulfill its responsibilities*. Standard 1110 also states that *the CAE must confirm to the board, at least annually, the organizational independence of the internal audit activity*. This means that *organizational independence is effectively achieved when the chief audit executive functionally reports to the board*.

Additionally, IIA Standard 1120: Individual Objectivity states that *internal auditors must have an impartial, unbiased attitude and avoid any conflict of interest*. A conflict of interest is a situation in which an internal auditor, who is in a position of trust, has a competing professional or personal interest.

Independence and objectivity are so important to the practice of internal auditing, that *if independence or objectivity is impaired in fact or appearance, the details of the impairment must be disclosed to the appropriate parties*.⁹

IPPF guidance related to independence and objectivity includes:

- Standard 1100: Independence and Objectivity.
- Standard 1110: Organizational Independence.
- Standard 1111: Direct Interaction with the Board.
- Standard 1112: Chief Audit Executive Roles Beyond Internal Auditing.
- Standard 1120: Individual Objectivity.
- Standard 1130: Impairment to Independence or Objectivity.
- Implementation Guides 1100, 1110, 1111, 1112, 1120, and 1130.
- Practice Guide: Independence and Objectivity.
- Practice Guide: Interaction with the Board.

INDEPENDENCE

According to the Standards:

Independence is the freedom from conditions that threaten the ability of the internal audit activity to carry out internal audit responsibilities in an unbiased manner.

Objectivity is an unbiased mental attitude that allows internal auditors to perform engagements in such a manner that they believe in their work product and that no quality compromises are made. Objectivity requires that internal auditors do not subordinate their judgment on audit matters to others.

IPPF

The International Professional Practices Framework (IPPF) is *the conceptual framework that organizes authoritative guidance promulgated by The IIA. Authoritative guidance is composed of two categories — (1) mandatory and (2) recommended.*

Section 2: Other Mandatory Guidance

In addition to the *Standards*, the other mandatory elements of The IIA's International Professional Practices Framework (IPPF) include the Definition of Internal Auditing, the Code of Ethics, and the Core Principles for the Professional Practice of Internal Auditing. Conformance with mandatory guidance is required and essential for the professional practice of internal auditing, and therefore an integral part of a strong foundation.

DEFINITION OF INTERNAL AUDITING

The Definition of Internal Auditing states the fundamental purpose, nature, and scope of internal auditing.

Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

CODE OF ETHICS

The Code of Ethics states the principles and expectations governing the behavior of individuals and organizations in the conduct of internal auditing. It describes the minimum requirements for conduct, and behavioral expectations rather than specific activities.

The IIA's Code of Ethics includes two essential components:

1. *Principles that are relevant to the profession and practice of internal auditing.*
2. *Rules of Conduct that describe behavior norms expected of internal auditors. These rules are an aid to interpreting the Principles into practical applications and are intended to guide the ethical conduct of internal auditors.*

THE CORE PRINCIPLES FOR THE PROFESSIONAL PRACTICE OF INTERNAL AUDITING

The Core Principles for the Professional Practice of Internal Auditing are the foundation for the IPPF and support internal audit effectiveness.

The Core Principles, taken as a whole, articulate internal audit effectiveness. For an internal audit function to be considered effective, all Principles should be present and operating effectively. How an internal auditor, as well as an internal audit activity, demonstrates achievement of the Core Principles may be quite different from organization to organization, but failure to achieve any of the Principles would imply that an internal audit activity was not as effective as it could be in achieving internal audit's mission.

CORE PRINCIPLES

- Demonstrates integrity.
- Demonstrates competence and due professional care.
- Is objective and free from undue influence (independent).
- Aligns with the strategies, objectives, and risks of the organization.
- Is appropriately positioned and adequately resourced.
- Demonstrates quality and continuous improvement.
- Communicates effectively.
- Provides risk-based assurance.
- Is insightful, proactive, and future-focused.
- Promotes organizational improvement.

MISSION OF INTERNAL AUDIT

The mission of internal audit is to enhance and protect organizational value by providing risk-based and objective assurance, advice, and insight.

IIA QUALITY SERVICES

IIA Quality Services helps CAEs validate and strengthen internal audit activities by enhancing effectiveness, efficiency, and successful practice implementation. To download complimentary *Insights to Quality* newsletters and find out more about IIA Quality Services, visit www.theiia.org/quality. The Quality Assessment Manual is available through The IIA Bookstore.

Section 3: Delivering World-class Internal Auditing

Quality is key to delivering world-class internal auditing. According to Standard 1300: Quality Assurance and Improvement Program, *the chief audit executive must develop and maintain a quality assurance and improvement program that covers all aspects of the internal audit activity*. Standard 1300 further explains:

A quality assurance and improvement program is designed to enable an evaluation of the internal audit activity's conformance with the Standards and an evaluation of whether internal auditors apply the Code of Ethics. The program also assesses the efficiency and effectiveness of the internal audit activity and identifies opportunities for improvement. The chief audit executive should encourage board oversight in the quality assurance and improvement program.

In “Core Principles and the QAIP,” Basil Woller emphasizes the importance of demonstrating the effectiveness of the Core Principles for the Profession of Internal Auditing, and explains how to do this through the quality assurance and improvement program.¹⁰

IPPF guidance related to quality includes:

- Standard 1300: Quality Assurance and Improvement Program.
- Standard 1310: Requirements of the Quality Assurance and Improvement Program.
- Standard 1311: Internal Assessments.
- Standard 1312: External Assessments.
- Standard 1320: Reporting on the Quality Assurance and Improvement Program.
- Standard 1321: Use of “Conforms with the *International Standards for the Professional Practice of Internal Auditing*.”
- Standard 1322: Disclosure of Nonconformance.
- Implementation Guides 1300, 1310, 1311, 1312, 1320, 1321.
- Practice Guide: Assisting Small Internal Audit Activities in Implementing the *International Standards for the Professional Practice of Internal Auditing*.
- Practice Guide: Quality Assurance and Improvement Program.

With so many standards dedicated to quality, delivering world-class internal auditing can seem overwhelming. But just as internal audit brings a systematic and disciplined approach to evaluating and improving the effectiveness of risk management, control, and governance processes, so should the CAE bring a systematic and disciplined approach to building a strong foundation.

A good place to start is with a readiness assessment. Offered by IIA Quality Services, an independent readiness assessment (gap analysis) focuses on the internal audit activity's current level of conformance with the Standards, and then makes recommendations for remediation of identified gaps to the IPPF. The readiness assessment also identifies opportunities to improve efficiency and effectiveness.

RESOURCES

The IIA offers in-depth learning that addresses the topics covered in this report, including in-person seminars, online self-directed courses, and on-site group seminars. Learn more at www.theiia.org/training or contact team development@theiia.org.

The IIA Bookstore offers a wide range of products to support building a strong foundation, such as *Essentials*, *World-Class Tools for Building an Internal Audit Activity*, 2nd Edition. For more information on any of the IIA publications mentioned in this document and other related products, visit www.theiia.org.

Conclusion

Strong internal audit activities are characterized by a sufficient number of competent internal audit staff, deployed effectively to achieve the approved audit plan. The CAE should look to the board to ensure that there is adequate budget to meet this need, including budget not only for compensation, but also for training, technology, travel, and other reasonable expenses to ensure that the internal audit activity is well-resourced. CAEs are best positioned to do this when they report functionally to the board.

The IIA's IPPF, broadly, and *Standards*, specifically, are fundamental components of an effective audit function. Failure to follow the *Standards* presents a potential risk to both the internal audit activity and to the organization. In a recent CBOK Stakeholder Survey, 98 percent of key stakeholders (board members and senior management) stated that they see value in internal audit's conformance with the *Standards*. CAEs in all organizations, regardless of size, sector, or industry, should **at a minimum**, conform with the *Standards* to strengthen their internal audit practices and demonstrate internal audit's value to senior management and the board.

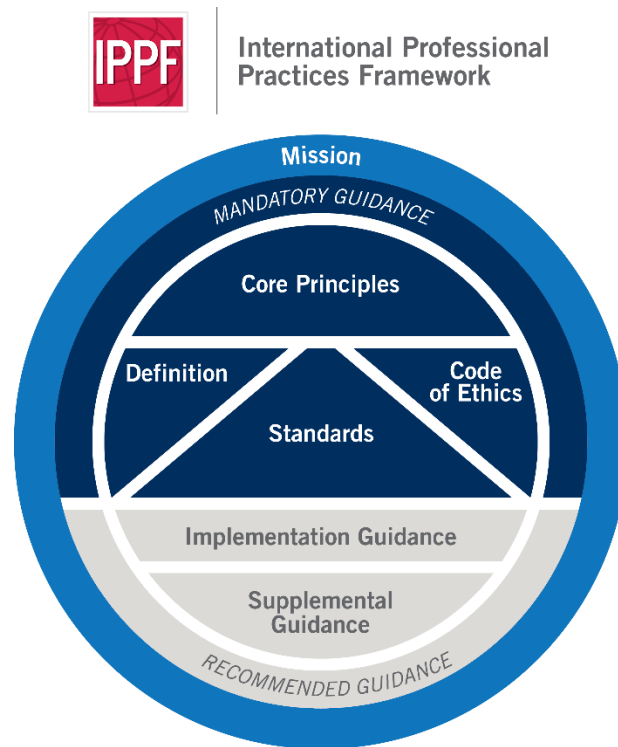
Resources, competence, structure, and the *Standards* are the cornerstones of a strong internal audit foundation. Quality is the mortar that holds the foundation together. This strong foundation positions CAEs for success in their efforts to lead internal audit activities that will *enhance and protect organizational value by providing risk-based and objective assurance, advice, and insight*.¹¹

As summed up by IIA President and CEO Richard Chambers, "There is significant disruption in the corporate sector that is impacting internal audit. From potential Trump-era deregulation to the emergence of complex new risks to conjecture about its loss of prestige, internal audit finds itself at the epicenter of issues that influence its scope of work, and that could damage its reputation and brand."¹² Now is the time for CAEs to make sure that their internal audit foundations can withstand the surrounding seismic activity.

The International Professional Practices Framework

Since 1947, the Institute of Internal Auditors has published guidance for internal auditors. The International Professional Practices Framework (IPPF), its forerunner first adopted in the 1970s, served the profession well on a global scale. But The IIA recognized, that for internal audit to keep up with an ever-changing environment, the IPPF needed to evolve to effectively support the profession and meet the many challenges that lie ahead.

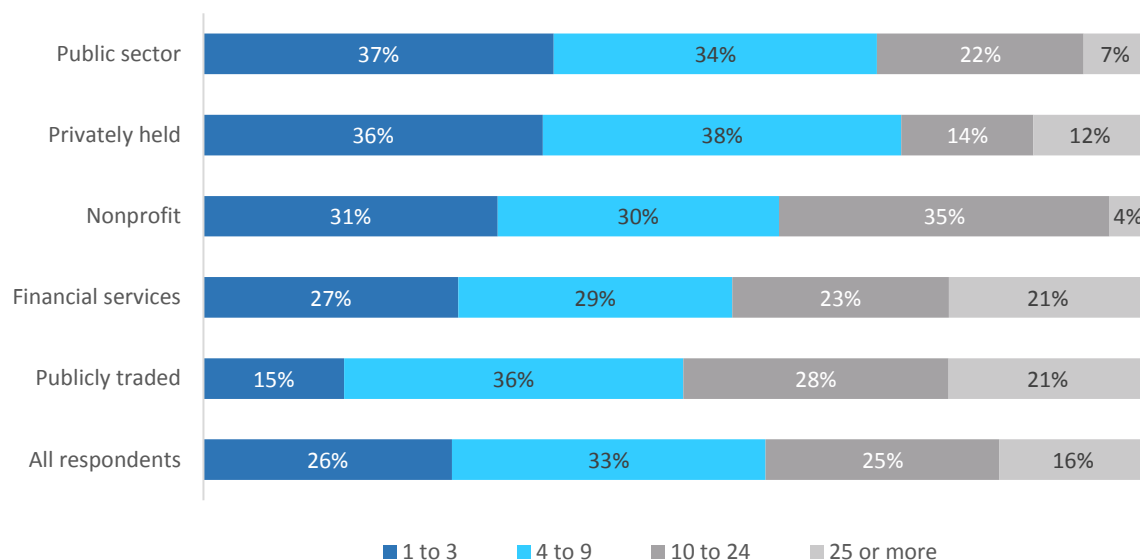
In July 2015, The IIA released an updated IPPF, encompassed by a Mission of Internal Audit that articulates what internal audit aspires to accomplish within an organization. Its place in the IPPF illustrates how practitioners should leverage the entire framework to facilitate their ability to achieve the Mission.



All elements of the IPPF, including Implementation Guidance and Supplemental Guidance, are free to IIA members.

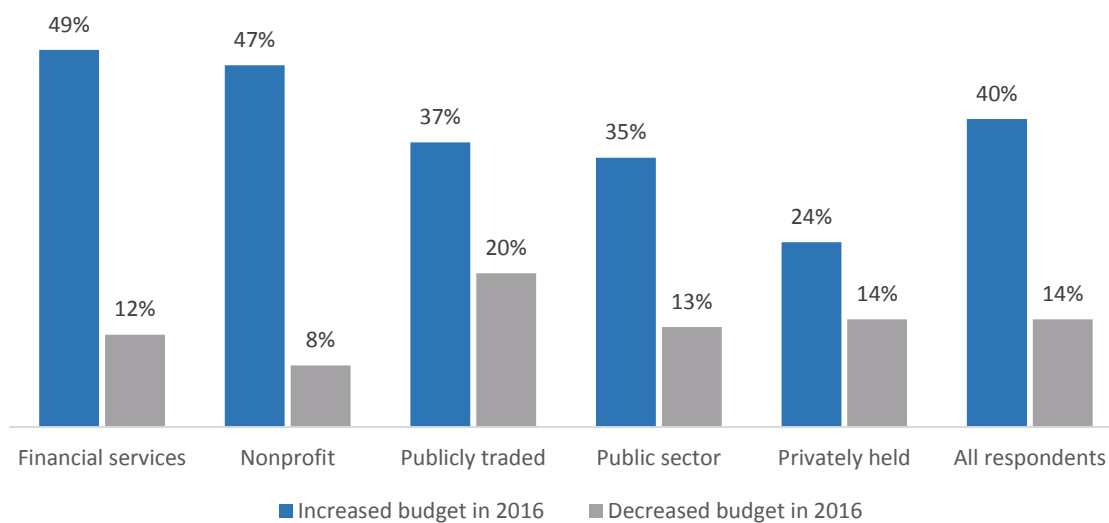
Appendix

Exhibit A: Internal Audit FTE Employees by Organization Type



Note: Q35: Approximately how many full-time equivalent employees make up your internal audit department? CAEs and directors, North America. $n = 520$.

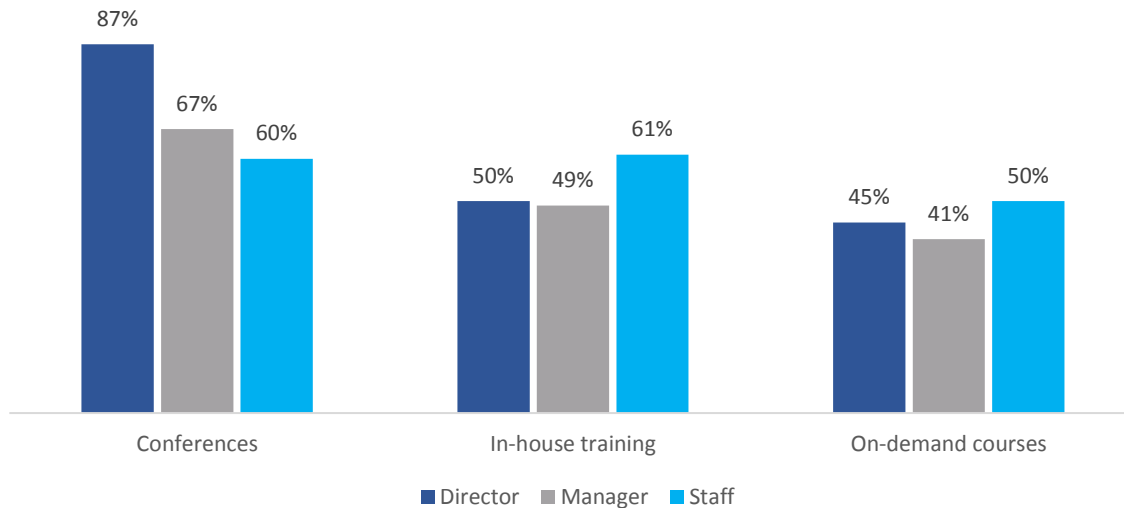
Exhibit B: Internal Audit Activities with Budget Increases or Decreases by Sector



Note: Q38: Looking back over the past 12 months, did the budget of your internal audit function increase, stay the same, or decrease? CAEs and directors, North America. $n = 512$.

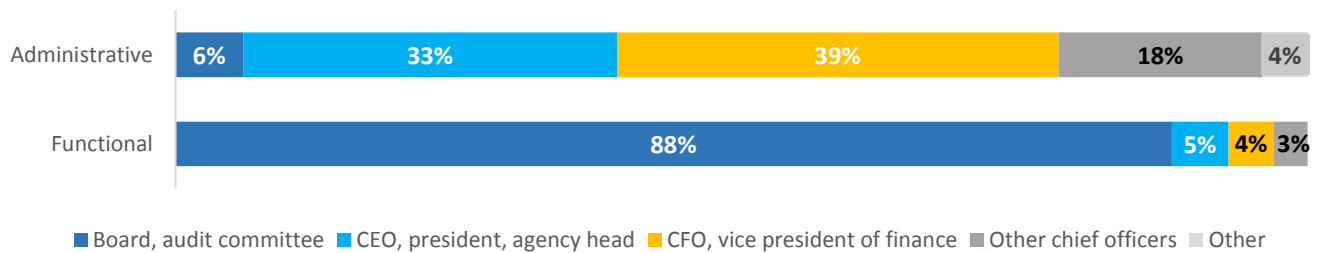
Appendix (continued)

Exhibit C: Methods of Training for Internal Auditors



Note: Q42: What methods of external training do you plan to use for each level of internal audit staff? (Select all that apply.) CAEs and directors, North America. *n* = 535.

Exhibit D: Functional and Administrative Reporting Lines



Note: Q33: What is the primary administrative reporting line for the chief audit executive (CAE) or head of internal audit in your organization? Q34: What is the primary functional reporting line for the chief audit executive (CAE) or head of internal audit in your organization? CAEs and directors, North America. *n* = 520.

Notes

¹ The IIA's Global Advocacy Platform, Pillar 4, accessed March 7, 2017, www.globaliia.org.

² IIA Standard 2030: Resource Management.

³ Implementation Guide 2030: Resource Management, The IIA's International Professional Practices Framework, 2017.

⁴ Richard F. Chambers "Internal Auditors Must Walk Their Talk When It Comes to Efficiency," March 6, 2017, chambersontheprofession.org.

⁵ Implementation Guide 1111: Direct Interaction with the Board, The IIA's International Professional Practices Framework, 2017.

⁶ IIA Standard 1210: Proficiency.

⁷ IIA Standard 1230: Continuing Professional Development.

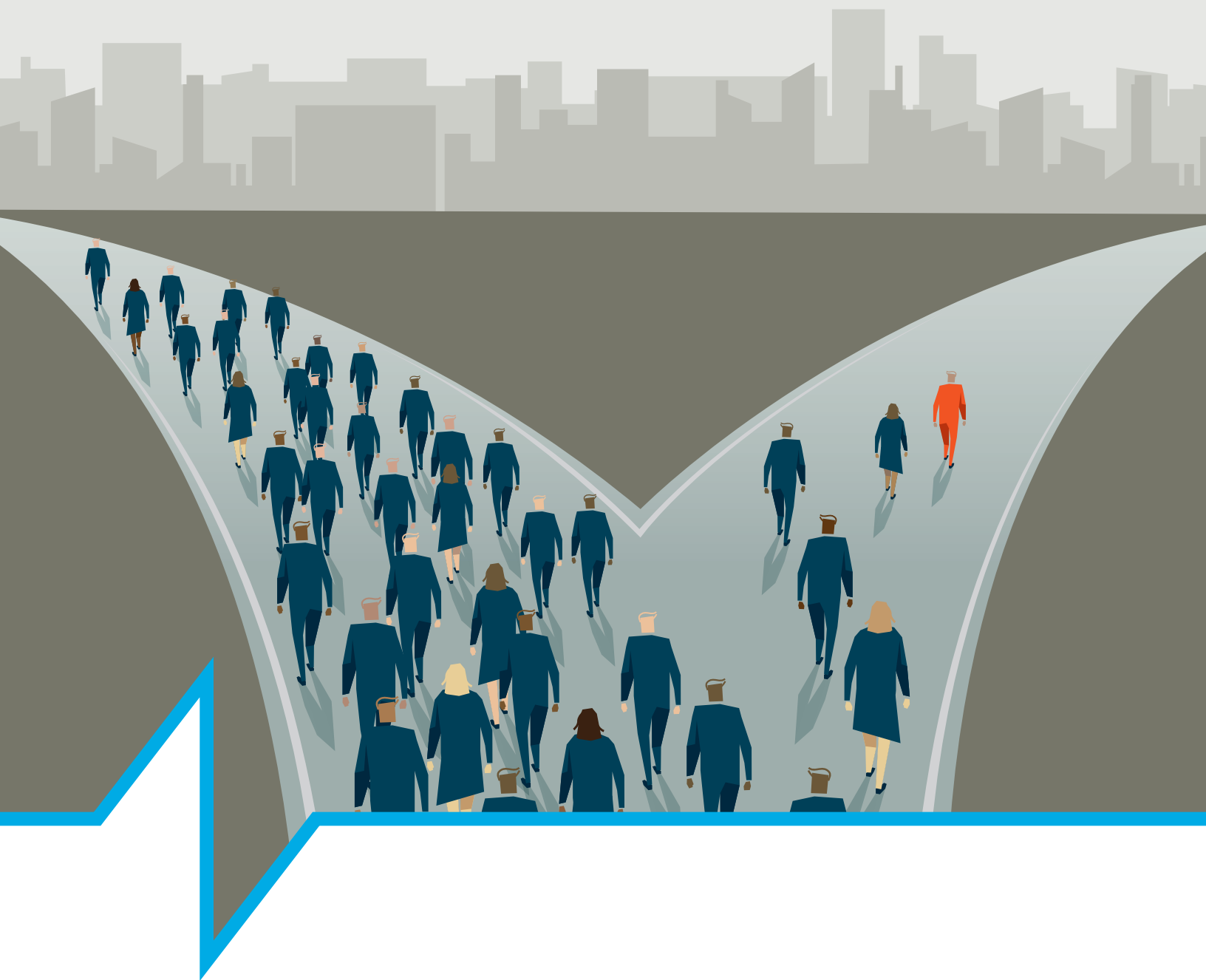
⁸ Implementation Guide 1230: Continuing Professional Development.

⁹ IIA Standard 1130: Impairment to Independence or Objectivity.

¹⁰ *Internal Auditor Magazine*, 31, The IIA, 2017.

¹¹ Mission of Internal Audit, IPPF, 2017.

¹² Richard F. Chambers, "For Internal Audit, the Best Defense Is a Strong Offense," April 3, 2017, chambersontheprofession.org.



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