

A photograph of three business professionals (two men and one woman) in a meeting. They are seated around a table, looking at documents and a laptop. The image is framed by a large, stylized circular graphic composed of overlapping, colorful segments in shades of orange, red, yellow, and dark blue.

Six Audit Committee Imperatives

Enabling Internal Audit to Make a Difference

A CBOK Stakeholder Report

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Introduction

The board of directors—whether it is the board in a unitary or single-tier structure or the supervisory board in a dual or two-tiered structure—is a key stakeholder of internal audit with needs that internal auditors are uniquely positioned to provide. Most often, the board’s primary interface with internal audit is through its audit committee.*

The CBOK 2015 stakeholder study offers insights as to the expectations of audit committees of internal audit. For audit committees, the insights provide a catalyst for taking stock of committee members’ interactions with and use of the internal audit function. For any progressive chief audit executive (CAE), these expectations offer opportunities to take the initiative to advance relationships with this vitally important stakeholder group by improving internal audit’s value proposition. Thus, the insights offer a pathway to continuous improvements that benefit all.

Three broad themes emerged from the study. Audit committees should:

- Enable internal auditors to think more broadly and strategically as they plan for, execute, and report on their work.
- Encourage internal audit to move beyond assurance to enhance its value proposition.
- Take steps to ensure CAEs and the internal audit function are effectively positioned to deliver to expectations.

The survey responses from directors serving on audit committees surfaced six imperatives of interest to audit committees that support these three themes. Following is a brief discussion on each of the six imperatives.

* In this report, the term “audit committee” applies to board committees by that name and to equivalent committees by another name. For example, in different countries and organizations, the name of the audit committee may vary (e.g., risk and audit committee, finance and audit committee, advisory committee on audits, audit advisory board, etc.). For purposes of this report, in the event the full board oversees auditing activities in lieu of a designated committee, the term “audit committee” applies to those situations as well.

1. Provide Perspective by Elevating the CAE’s Stature

When audit committees think about their expectations of internal audit, they should also consider how the CAE and the function itself are positioned to deliver on those expectations. Access and perspective have always been keys to positioning. Such access has typically been attained through direct reporting to the audit committee and the C-suite. But beyond these reporting lines, internal audit can benefit from a big-picture perspective to prioritize and address competing organizational demands. According to the stakeholder study, 2 out of 3 board members rank a CAE’s regular presence in appropriate board or board committee meetings as the most effective strategy for gaining that perspective. Attending board meetings, when coupled with attending key management meetings, is critical for a CAE.

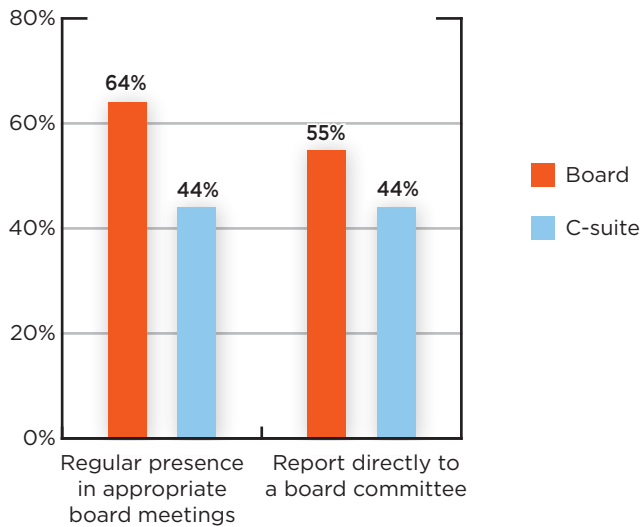
“[Our CAE balances competing priorities] by maintaining effective communication and a relationship with stakeholders, and by sufficient presence in board and audit committee meetings so that potential competing priorities can be fully discussed at the board level and consensus views are reached.”

—Board/Audit Committee Member, China

The second-highest rated strategy, as cited by 55% of board members overall, is the CAE reporting directly to the audit committee (see **exhibit 1**). Providing the CAE with this access has been enabled through the traditional interaction between the CAE and the board. Perhaps this gateway can be enhanced by granting the CAE “red phone access” to the audit committee and making this privilege known throughout the organization. Such escalatory authority can be useful to the audit committee if the CAE proactively exercises it to bring important matters to the attention of executive management and the board timely.

The survey results suggest there is an opportunity for boards to consider whether the CAE should attend not only all audit committee meetings but also other relevant board meetings. What is “relevant” in this context must be defined by directors to fit the organization’s specific needs.

Exhibit 1 Best Strategies to Address Competing Demands



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* = 917.

However defined, increased access to, and more frequent interaction with, the board broadens the CAE's perspective and elevates the stature and visibility of the internal audit function. It also enables the CAE to establish relationships with directors, understand their views on addressing competing audit priorities, and earn the right to be viewed as a source of insight. While the approach to board meeting participation may vary by organization and region, the point of this imperative is that the audit committee should focus on the question of whether the CAE's stature and perspective need elevating and, if so, how that might be accomplished.

2. Assist the CAE with Aligning Stakeholder Expectations

In most organizations, not all stakeholders see things the same way or want the same value from internal audit. This reality creates a significant challenge for CAEs in terms of building consensus. The CAE bears the brunt of the responsibility of addressing this challenge by articulating the value that a top-down, risk-based audit plan

"This is a difficult area for the internal audit function as the relationships are not strong—in part because the transparency of reasons for work/focus is not there...in part because the clarity of understanding the priorities of the business is not strong. Better relationships, improved transparency, and living the focus of being there to assist in everything that they do are essential."

—Chief Executive Officer, Australia

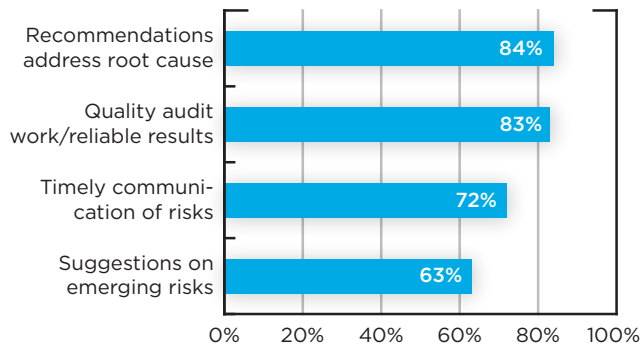
contributes to the organization and providing an assurance perspective that the board, executive management, and other stakeholders can understand. Because that is not easy, a question arises: how can the audit committee help the CAE bring about this alignment of stakeholder expectations? According to the CBOK study, the top four success factors that stakeholders consider in assessing internal audit performance are (see **exhibit 2**):

- Useful recommendations that address the root cause of identified issues
- Quality audit work and reliable results on key risk areas
- Timely communication of identified risks to appropriate stakeholders
- Consultative guidance—helpful suggestions on new emerging risk areas

"One of [our] company's values is trust. The activities of internal audit can be seen as not in line with this value, as many internal audit procedures involve checks and verification of the performance of employees and whether they are in compliance with the rules. So it is very important to explain why there is no inherent conflict. One of the challenges faced by our recently hired CAE is to increase the acceptance of internal audit within the company and promote its role as serving mutual purposes."

—Board/Audit Committee Member, Russia

Exhibit 2 Factors Stakeholders Consider in Assessing Internal Audit Performance



Note: Q24: What factors do you, as a stakeholder, consider when you assess and measure the performance of internal audit? $n = 939$.

The two highest success factors deal with the fundamentals of effective internal auditing. The next two relate to timely reporting on risk issues. While not rated as highly, three other success factors are not to be ignored:

- Perception of internal audit within the organization (44%)
- Performance related to specific expectations of stakeholders (36%)
- Quantitative value-added metrics (31%)

The audit committee should work with the CAE to ensure that internal audit performance is being measured consistent with how the board and management evaluate performance. Disconnects should be addressed timely so that the two are fully aligned. Keep in mind that this alignment is facilitated when the CAE is present at the appropriate board and management meetings, as noted in the first imperative.

“[Our CAE is] really building relationships with key stakeholders. This requires executive sponsorship to drive/create an environment to work together with internal audit. This provides visibility of the CAE to the business units.”

—Board/Audit Committee Member, Canada

3. Encourage Thinking Beyond the Scope

Audit committees should encourage internal auditors to think beyond the scope of the audit plan. The big-picture perspective of the first imperative and the strategic thinking suggested in the fifth imperative contribute to and enable this behavior. The mandate to think more broadly is not an either/or proposition. The CAE needs to challenge the audit team to “connect the dots” by thinking about the implications of audit findings across the organization so that audit communications are responsive to a business context that is broader than the boundaries set by the audit plan. Just because an issue is not in scope does not mean that audit committees and other stakeholders in the organization do not want to hear about it.

It also helps for internal audit to communicate what is *not* being audited or *cannot* be audited. In the CBOK stakeholder study, 21% of respondents indicate that internal audit does not communicate which of the organization’s risks or activities are not covered by the audit plan. Audit committees need clarity on this point.

“The CAE has to have an eye on future risks—crisis is always about events that have never happened before. Assuming current risk is taken care of, the priority should be to see the future risks. [The CAE needs] to plan for that.”

—Board/Audit Committee Member, Canada

To encourage “think beyond” behavior, the audit committee should practice it as well. Directors should ask internal auditors broader questions, such as:

- What is the real meaning of these findings? Is there a broader message we should be aware of?
- How are we driving value out of our compliance and assurance activities? For example, are there improvements to our processes that we need to make?

- How do these findings relate to other areas of our business? As leaders of the organization, what are we missing?
- Are there potential crisis events that we have not thought about and for which we are unprepared to respond?

The point is, audit committees should remind their CAEs that audits should not be a check-the-box exercise. If not yet over completely, that era is winding to a close. By having a view of the big picture through regular interaction with the board and thinking more broadly about the implications of their findings, internal auditors will be better oriented to think beyond the scope and deliver stronger, more practical, and harder-hitting recommendations aligned with what key stakeholders are seeking.

4. Direct Internal Auditors to Perform More Than Assurance Work

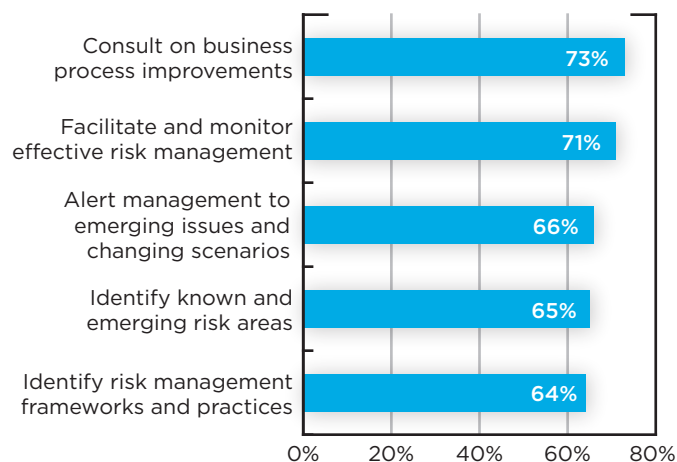
Internal audit need not be limited to assurance. In today's era of slower economic growth, a high premium is placed on operational effectiveness and efficiency. Survey respondents picked up on this point, as nearly 3 out of 4 recommended that internal audit consult and advise on business process improvements (see **exhibit 3**).

This finding makes sense because providing such advice certainly falls within the traditional ways that internal audit can help the organization (e.g., evaluate the risks resulting from changing operations and assess the necessary enhancements to controls that should be in place). However, when considering the magnitude and pervasiveness of changes that many organizations are undergoing, including the effects of business transformation initiatives driven by advances in digital technology and other factors, it becomes even more important as an imperative.

“CAEs should begin to understand culture, then identify specific risks they see from a business standpoint.”

—Board Committee Chair, United States

Exhibit 3 Areas for Internal Audit to Address Beyond Assurance



Note: Q10 to Q13: Which of the following areas should, beyond assurance, be in scope for internal audit? *n* = 836.

Seven out of 10 stakeholders suggest that internal audit should facilitate and monitor effective risk management practices by operational management to help with risk oversight. In addition, there are three areas recommended beyond assurance related to risk management.

Consistent with thinking more broadly pursuant to the previous imperative, audit committees should identify opportunities where internal audit can add the most value through performing advisory work. For example, the audit committee can authorize internal audit to evaluate and challenge the design and operating effectiveness of the organization's governance, risk management, and internal control processes that address its critical risks, with the expectation of a) receiving value-added recommendations to strengthen those processes, and b) keeping the committee informed regarding open matters.

“It becomes difficult for a single individual to be charged with assurance along with risk management consulting—an admirable objective but an overwhelming goal. Many organizations may not be receptive to this concept for one individual CAE.”

—Board Committee Chair, United States

The mix of assurance versus advisory activities depends on the maturity of the organization, the skillsets of the audit staff, the resources available to fill skills gaps, and the nature of the environment (e.g., highly regulated). While the target level of effort devoted to advisory probably falls within a range of 20% to 50% for most organizations, it goes without saying that the audit committee must approach advisory work by internal audit with caution. These efforts should not compromise the objectivity of internal auditors or prevent them from performing their assurance work.

5. Put Strategic Risks on the Table

Two out of 3 board members believe internal audit should have a more active role in connection with assessing and evaluating the organization's strategic risks. Notably, the numbers are even higher among chief executive officers (CEOs) (71%) and chief information officers (CIOs) (72%).

"The internal audit plan has to be supportive and can't be contrary to what the company is doing strategically. Must choose highest priority items and work against those."

—Chief Executive Officer, United States

This imperative for the audit committee relates to the CAE and the internal audit group focusing sufficiently on broader big-picture thinking. By understanding the organization's business objectives and strategy, and identifying risks that create barriers to the organization achieving its objectives and executing its strategy successfully, internal audit increases its value proposition to key stakeholders. To this end, the audit committee should empower the CAE to bring views and insights to stakeholders on risks to achieving objectives and executing strategy.

A key part of this imperative is working closely with executive management to position internal audit in the organization effectively. Internal audit has the proverbial "hall pass" to meet with business, process, and risk owners regularly. Why not leverage that privilege to add value?

Many board members seem to share this view. In the study, among the specific avenues designated by board members for internal audit to improve its role in assessing and responding to strategic risks facing the organization, the top two responses by far were:

- Focusing on strategic risks as well as operational, financial, and compliance risks during audit projects (86%)
- Periodically evaluating and communicating key risks to the board and executive management (76%)

"Internal audit has to be aware of what is happening in the organization and be observant when placed within the different functions of the organization—so being alert to things being not quite right and reporting on them (or discussing with the appropriate senior leader)."

—Board/Audit Committee Member, Australia

6. Prioritize High-Quality, Effective Communications

On a scale of 1 to 10, a strong majority of board members give high scores for the quality (83%) and frequency (81%) of internal audit's communications with them. This finding is important because, among other reasons, it ensures the audit committee and internal audit have an opportunity to address any gaps in the annual audit plan. Effective communications undoubtedly is a prerequisite for addressing the other key imperatives detailed above.

"Internal audit can definitely have a big impact on the culture of the organization and can make it more process driven, efficiency focused, and risk focused. They can also bring in a lot of transparency as matters highlighted by the internal auditor are dealt with at the highest levels."

—Chief Financial Officer, India

Effective communications enable the audit committee to work with internal audit leaders to better understand the internal audit process. To this end, directors should become more familiar with The IIA's *International Standards for the Professional Practice of Internal Auditing*, which is part of the International Professional Practices Framework (IPPF).

Why? With regard to the quality and frequency of communication, scores are higher among stakeholders who are familiar with the *Standards*. In addition, a majority of board members and executives believe it provides great value for purposes of enhancing the quality of internal audit activities. Specifically, 2 out of 3 board members (66%) are familiar with the *Standards*, and virtually all (98%) of them see value in internal audit conformance. Therefore, if audit committee members do not have adequate knowledge of the *Standards*, they should ask the CAE for more information about them and how internal audit is ensuring their conformance.

Conclusion

Audit committee members would be well-served to consider the six imperatives discussed in this report. Through these imperatives, audit committees can invigorate the internal audit function by positioning the CAE to think more broadly and strategically, move beyond assurance to provide value-added advisory services, and deliver to expectations. These actions will allow the audit committee to better leverage the insights delivered by internal audit.

About the Authors

Jim DeLoach has more than 35 years of experience in business consulting and auditing. His focus is on helping organizations succeed in responding to government mandates, shareholder demands, and a changing business environment in a cost-effective and sustainable manner that reduces risk to an acceptable level. He has served on the COSO Advisory Council for more than 10 years, contributing to the development of the 2004 *Enterprise Risk Management – Integrated Framework*, the COSO Project on Monitoring, the 2013 update to the *Internal Control – Integrated Framework*, and the current update to the ERM Framework. He is a member of The IIA and, for the last five years, has been named on the National Association of Corporate Directors' Directorship 100 list, recognizing him as one of the 100 most influential governance professionals in the boardroom community.

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STAKEHOLDER STUDY FACTS

Survey participants	1,124
Interview participants	100+
Countries	23
Languages	13

STAKEHOLDER POSITIONS REPRESENTED

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

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The Global Internal Audit Common Body of Knowledge (CBOK) is the world's largest ongoing study of the internal audit profession. The current study has two major components: practitioner and stakeholder. The practitioner study explores a variety of internal audit practices. The stakeholder study seeks out perspectives 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. Partially completed surveys were included in analysis as long as demographic questions were complete. Questions are referenced as Q1, Q2, and so on.

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