



# Achieving High Performance in Internal Audit

*Fourth Edition - Insights from the Audit Committee Chair*

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“If internal audit wants to rise up the chain,  
they need to demonstrate their worth.”

## Introduction

**For the past three years, the Institute of Internal Auditors – Australia (IIA-Australia) and Protiviti have conducted comprehensive surveys of Chief Audit Executives (CAEs) from over 160 organisations across all sectors, to capture trends and developments in the internal audit profession.**

In 2012, our research remains focussed on the major themes established in previous years; of internal audit independence, quality, skills and professionalism. However the key difference this year is we have sought to explore these issues from the perspective of the primary user of internal audit services - Audit Committee Chairs.

This report presents the main findings of roundtable discussions hosted by IIA-Australia and Protiviti, which brought together Audit Committee Chairs from leading organisations in the listed, private and public sectors. The roundtables were held in Sydney, Melbourne and Canberra in February 2012.

The major theme emerging from the roundtables was that CAEs should strive to ‘upskill’ in vital strategic areas such as leadership, communication and commerciality. While Audit Chairs universally considered internal audit’s assurance function to be indispensable, the single over-riding message was that CAEs must be much more than just exceptional technical operatives to get where they want to be – that is, become true partners with the Audit Committee and respected advisors to senior executives.

We trust that internal audit professionals will draw on the insights contained in this report to further improve their capabilities and the quality of service provided to their organisations.





# Authority and Independence

**Audit Chairs were unanimous that excessive management influence over the internal audit function was undesirable and required constant vigilance. They agreed that Audit Chairs had a responsibility to minimise unacceptable intervention.**

However several participants commented that this was a ‘two-way street’ as CAEs also had a role to play in asserting their own influence with management. Several Audit Chairs said, ‘CAEs have to earn the respect of the management team’. To gain management’s confidence, CAEs needed a sophisticated mix of skills and attributes including leadership, negotiation skills, an exceptional understanding of the business and an ability not just to raise the alarm, but also to make valuable recommendations to improve business performance. Audit Chairs were firmly of the view that CAEs with these abilities would have greater cooperation from management and be less likely to experience interference and ‘stonewalling’.

A healthy organisational culture was critical for an independent internal audit function and it was important for the Chief Executive (CEO) and Chair of the board to set the appropriate tone from the top. This could be achieved by the CEO or Chair affirming their support for the internal audit function in relevant communications to management. Private sector Audit Chairs said they regularly sought to promote the internal audit function by ensuring important report findings were highlighted and discussed in full board meetings.

Audit Chairs from the public sector believed they operated under different frameworks and governance cultures from the private sector, necessitating a different approach to assessing internal audit independence.

## Listed and private sector

A significant indicator of internal audit independence is whether the CAE has a direct functional reporting line to the Audit Committee. Participating Audit Chairs from organisations which lacked this reporting structure were alert to the potential for intermediate and senior levels of management to control or filter information provided by the CAE. Audit Chairs in this situation said their solution was to seek regular reassurance from the CAE that the reporting line allowed internal audit to fulfil its responsibilities and that the CAE had no concerns about independence. It was stated that Audit Chairs should establish an ‘open door policy’ with their CAE at the outset, to enable concerns to be aired and addressed.

Where management was improperly influencing internal audit, the Audit Chair could aim to resolve the issue by raising it with the CEO or Chairman of the board.



“Internal audit should drive the debate on the organisation’s total assurance program  
...Be a leader. Speak up. Have integrity”

## Public sector

Audit Chairs from the public sector firmly believed there was less latitude for undue management influence under the regulatory and governance framework applying to federal departments and agencies.

They believed the tight, centralised controls around remuneration setting for public sector personnel and strict 'natural justice' protections enjoyed by all staff from unjustified dismissals, made many of the traditional indicators of internal audit independence less relevant. They noted that while in the public sector it was common for the CEO or Department Secretary, rather than the Audit Committee to have the ultimate say in decisions to hire, fire, reward and remunerate the CAE, these powers were substantially limited by a regulatory framework which operated to hold the CEO/Secretary accountable for any improper decisions.

Audit Chairs also considered there were unique governance safeguards in the public sector which promoted responsible management behaviour. Examples of such safeguards included public scrutiny of management decisions and conduct under freedom of information legislation, the Senate Estimates process and oversight from the Australian National Audit Office (ANAO) which customarily attends the audit committee meetings of many departments and agencies.

Nevertheless, participants conceded that on the flipside, there were structural barriers in the federal public sector impeding a CAEs ability to gain credibility and influence with senior executives.

The strong hierarchical structure of the public service was one such barrier. Participants observed that the challenge for the profession was that the majority of CAE roles were clustered at middle management level (EL band) with very few established at the senior executive level (SES band), on a par with senior management. This structural inequality automatically made it more difficult for an EL-ranked CAE to influence a senior department manager from the SES ranks.

Despite this, there were some practical solutions to improve internal audit's influence. For example, Secretaries or Deputy Secretaries could establish a direct reporting line with an EL-ranked CAE, thereby bypassing intermediate reports. This would allow internal audit concerns to be raised directly with an SES-ranked manager who could elevate the profile of any pressing issues. While Department Secretaries could not unilaterally create new SES positions to recognise capable CAEs, they had some discretion to reward high-performing internal auditors with greater responsibilities and a degree of performance pay.

The rank and seniority constraints on internal audit in the public sector reflected a prevailing view that internal audit was predominantly a technical function. Public sector internal auditors would need to consistently demonstrate a more sophisticated skill-set to break down these perceptions.

Audit Chairs observed that a further structural constraint was that Audit Committees in the public sector did not have the same authority as listed company boards to act as a check against the Chief Executive or Secretary. As such, the significance of the internal audit function and whether it would have the latitude to properly fulfil its governance role was directly linked to the Secretary's own appreciation and support of the function.

## Skills and resourcing

**All Audit Chairs agreed that IT and project management skills were the areas of greatest skills shortage within the internal audit function. These were generally considered specialist skill-sets and tended to be outsourced or co-sourced. Audit Chairs were inclined to 'buy in' project audit experience at strategic stages in a project's lifecycle to ensure it was designed appropriately, 'on track' and capable of meeting outcomes.**

Participants were referred to the third edition of the IIA-Australia – Protiviti CAE Survey which found that internal audit was allocating its attention across sections of the business in the following proportions: Operational (29%); Financial (21%); Compliance (15%); Risk management (10%); IT (12%); Governance (6%); Fraud (6%); and other (1%).

Audit Chairs felt this mix of areas was appropriate and accorded with their own view of how internal audit should distribute its efforts.



“CAEs have to earn the respect of the management team”

## Audit Chairs' Top Tips for CAEs

- Be strategic, commercial and 'a leader'
- Understand what your Audit Committee needs, report the right amount of detail and communicate with impact
- Have a 'point of view' on everything you put before the Audit Committee
- Don't just raise 'problems'. Come up with solutions and recommendations to improve business performance
- Prioritise your recommendations and make sure they are commercial
- Be proactive with your Audit Chair. Keep them regularly informed on what management is doing and thinking and help them to help you

## Quality

### IPPF Compliance

IIA-Australia believes that quality and effectiveness in internal audit is achieved through full compliance with the internal audit standards prescribed in the IIAs International Professional Practices Framework (IPPF).

An overwhelming majority of participating Audit Chairs said their organisations' internal audit functions had recently undergone an external quality assessment (EQA) to demonstrate they complied with the IPPF. There was consensus on the importance of performing an EQA and a view that the five-year cycle was reasonable.

Some participants noted that they would insist on an EQA even if it were not an IPPF requirement. Given internal audit's critical assurance role and the heightened need for independence, it was crucial to have an external, independent assessment of the function.

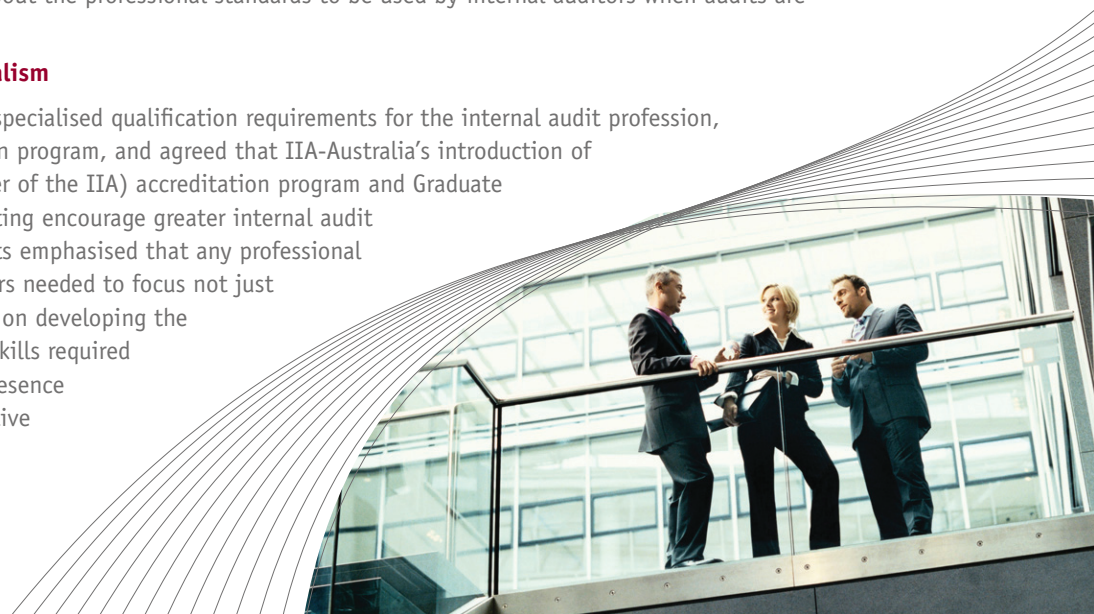
All participants agreed that the level of awareness among Audit Committee members of the Standards was mixed. Nevertheless, they took great comfort from knowing their organisations were Standards-compliant through the EQA process.

Participants were also keen to stress that full compliance with the Standards was an important but not a 'stand-alone' condition for an effective internal audit function. Other fundamentals were having internal auditors with the right 'soft' skills and attributes and a transparent organisational culture.

Public sector Audit Chairs added that they expected Audit Committee awareness of the IPPF to improve in light of the introduction last year of Regulation 22C of the Financial Management & Accountability Amendment Regulations 2011 (Commonwealth). The regulation specifies that one of the Audit Committee's roles is advising the CEO about the professional standards to be used by internal auditors when audits are undertaken.

### Internal audit professionalism

All Audit Chairs welcomed specialised qualification requirements for the internal audit profession, such as the CIA certification program, and agreed that IIA-Australia's introduction of the CMIIA (Certified Member of the IIA) accreditation program and Graduate Certificate in Internal Auditing encourage greater internal audit professionalism. Participants emphasised that any professional program for internal auditors needed to focus not just on technical skills but also on developing the right mix of interpersonal skills required to give internal auditors presence and influence at the executive table.



## Value of internal audit

### Listed and private sector

All private and listed sector Audit Chairs placed high reliance on the assurance provided by internal audit. They noted that internal audit's greatest value was as the 3rd line of defence, in evaluating the effectiveness of risk management, control and governance processes.

Listed sector Audit Chairs saw internal audit's assurance role as very important in helping audit committee directors fulfil their legal duties. One participant said, "internal audit keeps me out of jail." They felt that risk-based assessments or 'hotspot' reviews had been a very useful tool for elevating compliance issues to the full board.

However, they also recognised that many CAEs were keen to extend their remit from routine assurance activities, to 'consulting-style' activities such as business process reviews. Participants stated that while they did not view consulting-style activities as internal audit's 'main game', they supported allocating some resources to them, provided the Audit Committee was confident in the level of assurance coverage.

Audit Chairs also expressed caution about internal audit venturing into 'special audits' of areas where they lacked appropriate knowledge and expertise or where they could not perform sufficient testing. One Audit Chair said, "I get nervous when my internal auditors want to provide more 'value-added' services. High-level reviews cause me great concern. Sampling a few items in a business process review gives me no comfort at all".

Audit Chairs appreciated that management might have a different perspective on where internal audit's value lay. They said, in contrast, that management would have a preference for more 'consulting type' activities. In addition, participants felt that an internal audit function that was consistently focussed on identifying problems and raising 'negatives' was less likely to be highly valued by executives.

### Public sector

Public sector Audit Chairs agreed that internal audit's primary role was to provide assurance to the Audit Chair and Secretary. Participants felt that internal audits examining the culture, processes and performance of the organisation were most valued. Internal audits which identified the root causes of problems and proposed practical solutions were highly regarded. It was noted that while internal audit's involvement in project and program reviews was very resource-intensive, the insights gained on how to improve such programs were invaluable to management. They also valued auditors applying a genuine risk-based approach to internal auditing as this would reduce protracted audit timeframes and improve efficiency.

### Assurance mapping

All Audit Chairs wanted to see internal audit 'driving the debate' on the organisation's total assurance program. To become a leading advisor, internal audit should drive a risk assurance mapping process for the entire organisation to identify gaps and overlaps in coverage and to reconcile conflicting views where there are multiple assurance providers.

## What Audit Chairs said

- CAEs must shore up their leadership, communication and commercial skills to 'rise up the chain' and become true partners to the Audit Committee and respected advisors to senior executives
- CAEs who have earned management's respect are less likely to experience management interference or coercion
- There's a gap between Audit Chairs and Management over the value of internal audit. Audit Chairs value compliance and assurance activities. Management see greatest value in business consulting-style activities
- The usual signs of internal audit independence – like the power to hire, fire and remunerate internal auditors – are less relevant in the public sector
- The public sector hierarchy can limit internal audit's ability to influence senior management
- Full compliance with the IIA's professional standards and performing external quality assessments of the internal audit function is crucial







“Don’t just raise ‘problems’.  
Come up with solutions and recommendations to  
improve business performance”

## Enhancing internal audit services and capabilities

All Audit Chairs noted that their CAEs technical skills were generally of a high standard. However, they strongly advised that for a CAE to progress to a real partner to the Audit Chair and valued advisor at the executive table, it was crucial they demonstrate a range of additional skills.

### Quality reporting

Internal audit reports are the CAEs key deliverable and must reflect the CAEs professionalism and competence. Reports need to be timely, concise and present an accurate and succinct picture of issues, implications and responses. An audit may raise a multitude of actionable issues but the CAE must exercise judgement in deciding which are appropriate for the board’s consideration. Lower level issues should not be neglected; these should still be reported but to an appropriate level within the business.

Reports should also communicate with impact. This may entail greater use of graphics. Language used should also be factual, de-personalised and non-emotive.

Participants recommended the periodic reports to the Audit Committee include ‘themes’ and /or ‘trends’ to alert the Committee in a timely manner to emerging issues.

### Quality recommendations

Audit Chairs stated that CAEs should have a ‘point of view’ and well-considered solutions on any issue put before the Audit Committee. Recommendations need to reflect not just a control mindset. They should also be underpinned by a sophisticated understanding of the business. They should not be impractical to implement and should consider where relevant, scope for greater efficiencies, cost control or better performance. CAEs who required a second opinion on any proposal should consider using their Audit Chairs as sounding boards.

Audit Chairs did not want to receive a mountain of recommendations where the ‘nice-to-haves’ were indistinguishable from the ‘must-haves’. Recommendations should always be

prioritised and judgement exercised on which matters merited the Audit Committee’s attention. A consistent theme was ‘quality of recommendations, not quantity of observations’.

### Exceptional interpersonal skills

Technical skills will only get a CAE so far in gaining credibility with the board and senior executives. CAEs also need excellent communication, presentation, negotiation, influencing and leadership skills to give them the profile and strategic impact to make an impression on an organisation’s most senior decision-makers.

The advice of one Audit Chair was, “Be a leader. Speak up. Have integrity. Exercise good judgement. Stand up for yourself. And bring your team with you”.

CAEs should work on cultivating a strong, trusted relationship with their Audit Chair. This could be facilitated by keeping the Audit Chair regularly informed on what management is doing and thinking, and by being proactive with any concerns. Several Audit Chairs said ‘help us to help you’. They urged CAEs to be innovative in recognising the strengths of the Audit Committee and to present their concerns in a way that helps the Committee to identify how it can support internal audit.

### Commercial understanding

A strong, consistent theme was that ‘internal audit needs to understand the business and be more commercial’. All Audit Chairs emphasised this was key to gaining credibility with management and demonstrating that internal audit was more than a compliance function. CAEs must shore up their credentials as strategic thinkers to advance their careers.

## Further information

The “*Achieving High Performance in Internal Audit*” study aims to capture developments and trends in the internal audit profession. The full report is available on our websites: [www.iaa.org.au](http://www.iaa.org.au) and [www.protiviti.com.au](http://www.protiviti.com.au).

## NATIONAL OFFICE

The Institute of Internal Auditors - Australia  
PO Box A2311  
Sydney South NSW 1235  
AUSTRALIA  
Ph: + 61 2 9267 9155  
Fax: + 61 2 9264 9240  
[enquiry@iaa.org.au](mailto:enquiry@iaa.org.au)  
[www.iaa.org.au](http://www.iaa.org.au)  
Level 7/133 Castlereagh Street  
Sydney NSW 2000 Australia

IIA-Australia's purpose is to support the profession and those who work in it for the public good. Our vision is to achieve genuine professional body status by 2020.

IIA-Australia provides internal auditing practitioners, executive management, boards of directors and audit committees with standards, guidance and information on internal auditing best practices. Established in Australia in 1952, IIA-Australia has chapters across the country. Globally, the IIA serves more than 170,000 members. The IIA is recognised as the internal audit professions leader in certification, membership, learning and development, research, technical guidance, quality services, policy and advocacy throughout the world.



## BRISBANE

Level 15,  
333 Ann Street  
Brisbane, QLD 4000  
AUSTRALIA  
Ph: (07) 3039 4000  
Fax: (07) 3039 4098  
[brisbane@protiviti.com.au](mailto:brisbane@protiviti.com.au)

## CANBERRA

Level 5,  
71 Northbourne Avenue  
Canberra, ACT 2600  
AUSTRALIA  
Ph: (02) 6113 3900  
Fax: (02) 6262 7567  
[canberra@protiviti.com.au](mailto:canberra@protiviti.com.au)

## MELBOURNE

Level 17,  
140 William Street  
Melbourne, VIC 3000  
AUSTRALIA  
Ph: (03) 9948 1200  
Fax: (03) 9602 5225  
[melbourne@protiviti.com.au](mailto:melbourne@protiviti.com.au)

## PERTH

St Martins Tower, Level 19  
44 St Georges Terrace  
Perth, WA 6000  
AUSTRALIA  
Ph: (08) 6430 6801  
Fax: (08) 9325 9605  
[perth@protiviti.com.au](mailto:perth@protiviti.com.au)

## SYDNEY

Level 45, MLC Centre  
19 Martin Place  
Sydney, NSW 2000  
AUSTRALIA  
Ph: (02) 8220 9500  
Fax: (02) 9247 7241  
[sydney@protiviti.com.au](mailto:sydney@protiviti.com.au)

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