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Harnessing the full  
potential of Internal Audit  
To protect and enhance



Internal Audit is not a one-size-fits-all function, and typically not everyone in the organisation agrees on what its primary focus should be.

If you ask yourself as an audit committee member what you see as internal audit's primary function – assurance and value protection, strategic focus and value creation, business risk insights and risk mitigation, or any combination thereof – and compare your response to those of other key stakeholders in your organisation, you may be surprised at the range of opinions you encounter.

The key activities of leading-edge internal audit functions align with the expectations of the audit committee and management, and are flexible enough to meet the changing business strategies and needs of the organisation.

Often, internal audit concentrates on financial and compliance areas; however, in some organisations, more of an enterprise risk focus may be adopted – one that considers strategic and operational risks as well as financial and regulatory risks, with internal audit serving as a strategic adviser.

To continue to enhance the performance of the internal audit function and its value to the organisation, we believe that audit committees should periodically ask whether internal audit is performing the appropriate activities, has adequate resources, and is proactively identifying risks and monitoring critical controls.

Here we explore the audit committee's role and share our insight on how best to harness the full potential of your internal audit capability.

### **Aligning and measuring internal audit expectations**

In many organisations, audit committees and management both have differing expectations of internal audit.

An optimised internal audit function can provide the balance between protecting and enhancing enterprise value by taking a holistic approach to risk management across the enterprise and providing independent and objective assurance with value-added advice.

For internal audit to be successful, it is important for the Head of Internal Audit (HIA) to clearly understand the following from the audit committee and management:

- The specific expectations for internal audit.
- The perception of the value that internal audit adds to the organisation and the audit committee.
- How the success of internal audit activities is measured.

An effective relationship between the audit committee and internal audit is fundamental to internal audit's success. The audit committee clearly sets and articulates expectations of strategic focus, providing the appropriate level of support for achievement, and holding internal audit accountable.

Key performance measures will vary significantly depending on internal audit's strategic emphasis; however, an evaluative approach that measures quantitative and qualitative factors should be considered.

In addition to regularly reviewing performance metrics and recalibrating internal audit's activities when appropriate, the audit committee and internal audit may consider periodically revisiting the alignment of expectations and how internal audit supports the strategic and operational objectives of the organisation.

Because risks and opportunities constantly emerge, it is important for internal audit's charter, risk assessment process, and audit plan to be dynamic enough to allow internal audit to take a proactive and forward-thinking approach.

If you were to take a look back at your organisation's internal audit plan from a few years ago, it is unlikely that areas such as corporate responsibility and sustainability, anti-bribery and corruption, cyber threat management, ethics, cloud computing, or social media were addressed.

The more dynamic the internal audit function and its activities, the more effectively internal audit can support the organisation in adapting to emerging issues and responding based on a changing risk profile.

**Questions for audit committees to consider in evaluating internal audit:**

- Does internal audit have a clearly articulated strategy that is reviewed periodically and approved by the audit committee?
- Does internal audit have a clear set of performance expectations that are aligned with the success measures of the audit committee, and that are measured and reported to the audit committee?
- Does internal audit have a charter that is periodically reviewed and approved by the audit committee? Does internal audit operate in accordance with its charter?
- Is the internal audit plan aligned to the key risks of the organisation and other assurance activities?
- Is internal audit's risk assessment process appropriately linked to the company's enterprise risk management activities?
- In delivering the internal audit plan, is internal audit flexible and dynamic in promptly addressing new risks and the needs of the audit committee?
- Does internal audit organise or perform self assessments of its performance and report the results to the audit committee?

It is important that the audit committee, as well as management, have full visibility into the activities of internal audit, and that it be involved in the development of the function's objectives, audit plan, and activities.

An essential component of the relationship with internal audit is the audit committee's monitoring of the results of internal audit's quality assurance and improvement program. Such a program, which includes both internal and external assessments, is required for compliance with the *Institute of Internal Auditors' International Standards for the Professional Practice of Internal Auditing*, and is designed to enable an evaluation of the internal audit function, assess its efficiency and effectiveness, and identify opportunities for improvement. The results of these assessments, should be discussed on a timely basis with the audit committee.

Audit committees may also consider engaging an experienced external party to perform a strategic assessment of internal audit to aid in challenging and setting internal audit's role in the organisation. This assessment primarily focuses on optimising internal audit to bring the most value to the company and the audit committee. It can help the audit committee answer tough questions about internal audit's performance and practices and align internal audit's activities with the organisation's strategic objectives and priorities.

**Questions for audit committees to consider in evaluating internal audit:**

- Is internal audit appropriately funded and staffed?
- Is internal audit staffed with the appropriate mix of professionals to achieve its objectives?
- Is internal audit sufficiently independent of management?
- Is the HIA respected as an adviser to the audit committee and management on emerging risks?
- Is internal audit highly regarded and respected in the organisation?

**Securing the appropriate resources for internal audit to meet expectations**

In many organisations, the audit committee is responsible for approving the internal audit budget, and this approval is typically based on management's recommendation.

How often does the audit committee challenge the recommended internal audit budget?

In many organisations, internal audit, like other areas of your business, may be under pressure to contain or decrease its expenses while responding to emerging risks and the expectations of audit committees and management to expand coverage. There are certainly opportunities for internal audit to challenge its historical budget and do more with less. Greater use of technology, such as effectively leveraging data analytics, and the utilisation of outside service providers as a cost effective means of performing internal audit projects, are just two considerations for doing so.

While the audit committee may first consider whether internal audit is effectively using available resources, it may also want to assess whether the function is appropriately funded and staffed to meet expectations. One consideration is whether internal audit has the appropriate mix of skills to achieve its strategic objectives and proactively identify and address current and emerging risks. An effective evaluation by the audit committee of the appropriateness of resources is not limited to the internal audit team, but also includes the HIA.

The reporting structure of the HIA can also be considered in evaluating the effectiveness of internal audit. In many organisations, the HIA reports functionally to the audit committee and administratively to the CFO. This dual reporting structure, particularly when considered with the effects of rotational models and performance and compensation processes driven by the CFO, can present real or perceived issues in terms of independence and effectiveness.

Audit committees can help mitigate this challenge through having an open and transparent relationship with internal audit that allows the HIA to regularly and freely discuss issues and concerns outside the presence of management, and through actively participating in the HIA's performance evaluation and compensation process.

The perception of the experience and knowledge of the HIA and the internal audit team can also affect how internal audit is regarded and respected in the organisation. If the HIA is viewed as not having the appropriate stature in the organisation, or if the HIA or the internal auditors are viewed as lacking the necessary business acumen, internal audit may not have the respect and visibility needed to be effective.

#### Questions for audit committees to consider in evaluating internal audit:

- Is the level of assurance provided by internal audit and its interaction with other assurance sources clear and appropriate for the audit committee?
- Does internal audit meet regularly with the external auditors to discuss risk assessments, the scope of procedures, or opportunities to achieve greater efficiencies and effectiveness across the company's audit services?

#### Understanding internal audit's role in the organisation

In assessing the effectiveness of internal audit, it is critical the audit committee understands how internal audit relates to, and interacts with, other risk or assurance-related functions, such as enterprise risk management, legal, security, health and safety, loss prevention, and compliance.

This includes evaluating who is doing what and whether there are any gaps or duplications between internal audit and these groups regarding the assurance being provided.

It is also important that the audit committee understands how internal audit interacts with the external audit provider.

Greater efficiencies and effectiveness can be achieved if the two work together. In addition, the external auditor's perception of an organisation's internal audit function can be an important indicator to the audit committee.

### **Fostering a mutually beneficial relationship with internal audit**

Communication is an important component in maintaining an effective relationship between the audit committee and internal audit. Clear articulation by the audit committee of its expectations regarding both formal and informal communications can help facilitate a successful relationship and support internal audit in meeting its objectives.

Internal audit's communications should be timely, actionable, and relevant, with a priority on the implementation of recommendations and resolution of issues. In some organisations, inadequate focus is placed on reporting, follow-up, and resolution activities. This can result in information not being reported timely to the audit committee or not being presented at the appropriate level of detail; just as importantly, known issues may not be timely or effectively addressed. In addition, it is important that the audit committee understand the depth and breadth of coverage by internal audit to avoid having a false sense of assurance regarding the scope of internal audit's activities.

**Questions for audit committees to consider in evaluating internal audit:**

- Are issues identified and reported by internal audit appropriately highlighted to the audit committee, and is the progress to effectively completing management actions tracked and reported?
- Is internal audit timely and proactive in the conduct and reporting of issues and in addressing them with management?
- Are reports and other communications from internal audit to the audit committee of an appropriate standard of presentation and provided value?

An HIA with executive presence and strong communication skills who provides ongoing communications that are direct, relevant, frequent, and timely and that demonstrate the appropriate level of rigor in confirming the resolution of audit issues will have greater authority and credibility with both the audit committee and management. Effective internal audit communication with the audit committee can also foster the ability of the audit committee to use the HIA as an internal source of information and insight on evolving business strengths and challenges, as well as the climate of internal controls in the organisation.

Audit committees may consider the following objectives for internal audit communications in helping the function spur positive change in the organisation:

- Be informative.
- Be objective and accurate.
- Serve as a catalyst for action.
- Educate.
- Provide clarity on important and complex issues.
- Gain respect.
- Be persuasive.
- Avoid surprises.
- Provide value.

## **Conclusion**

It has become increasingly important for audit committees to assess whether internal audit is performing the appropriate activities, has adequate resources, and is proactively identifying risks and monitoring critical controls.

The specific expectations for internal audit functions vary by organisation, but audit committees can facilitate a mutually beneficial relationship by setting high expectations, clearly communicating these expectations, and holding internal audit accountable for meeting them.

By performing a periodic assessment of internal audit, audit committees can help align expectations with other key stakeholders, support the HIA in assessing the function's ability to meet expectations, and secure resources as needed. This assessment can help the audit committee to confirm that internal audit meets the needs of the organisation, both today and in the future.

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