

Advisory Services  
Performance Improvement

Market Survey

# Internal Audit

Getting Ready for Quality Assurance Review



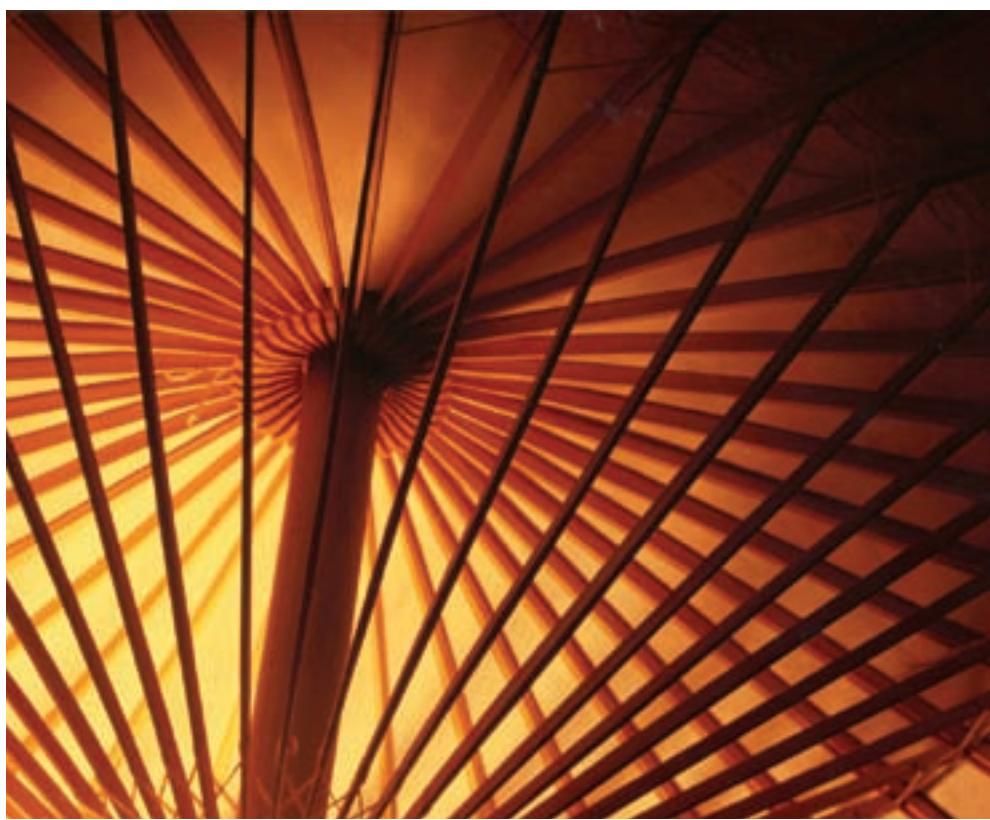
Czech Republic  
November 2006



Market Survey

# Internal Audit

Getting Ready for Quality Assurance Review



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# Executive Summary

# Introduction

- The survey was completed in July & August 2006 and is building on similar surveys conducted in 2001 and 2003.
- In 2006, we organised the survey as a joint initiative with the Czech Institute of Internal Auditors (ČIIA).
- Our objective is to provide an independent forum to report on key trends, and emerging issues regarding many aspects of the Internal Audit ("IA") function in various industry segments operating in the Czech Republic.
- The key focus of this year's survey is quality of internal audit, especially the current topic of getting ready for an external Quality Assurance Review.

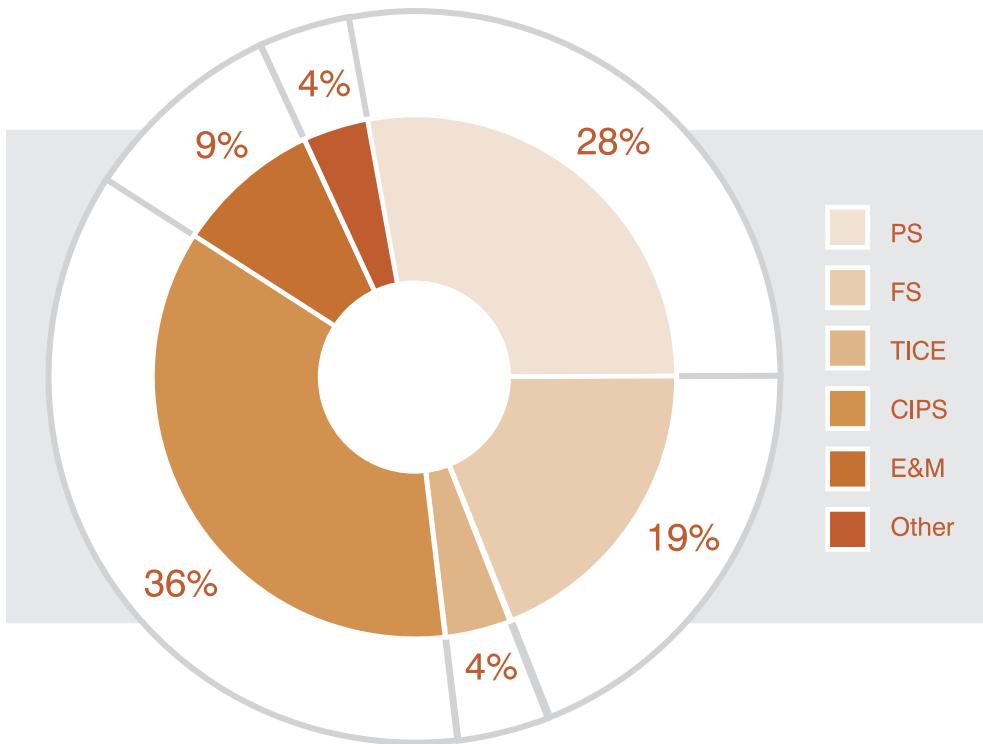


## Response Base

- We mailed surveys to the internal auditors or CEOs (When IA contact was not available) of some 400 companies throughout the Czech Republic and we received back about 80 responses.
- None of the results that we received from any individual organisation has or will be published individually.
- We would like to thank all of the respondents for their participation in this survey.
- The overall survey response rate was 20%, with 79 responses being received from companies to whom the surveys were mailed.
- A detailed analysis of the response rate and the response base by industry segment, number of employees and turnover category is presented on the following pages.

## Response by industry segment

## Percentage of total responses by industry segment



PS: Public Sector

FS: Financial Services

TICE: Technology Information, Communication, Entertainment

CIPS: Consumer Industrial Products &amp; Services

E&amp;M: Energy &amp; Mining

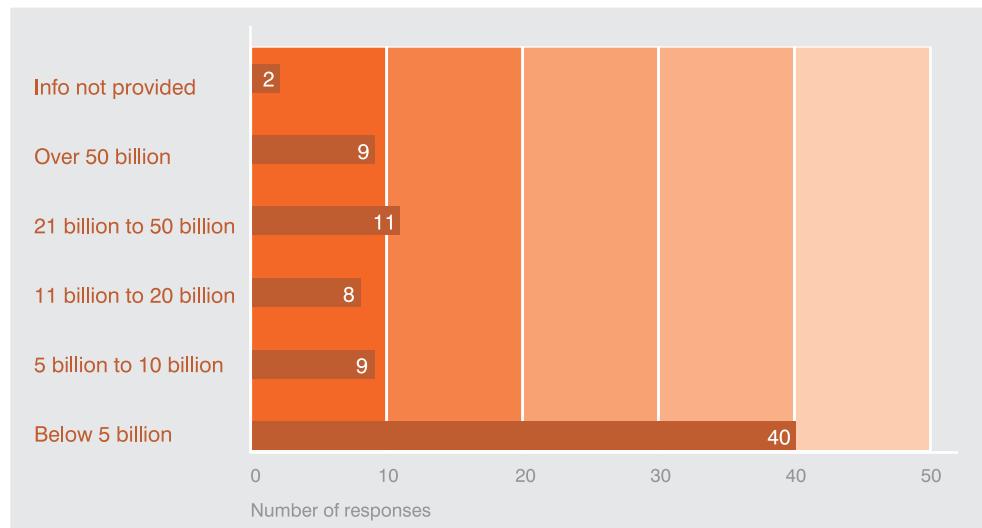
## Commentary

The type organizations participating in the survey:

- The majority of companies operate in the service or general manufacturing industry segment. A significant portion of responses came from financial services and the public sector.
- Typical annual turnover below CZK 5 billion with remaining turnover categories spread evenly.
- The majority of organisations (more than 50 %) have up to 1500 employees.

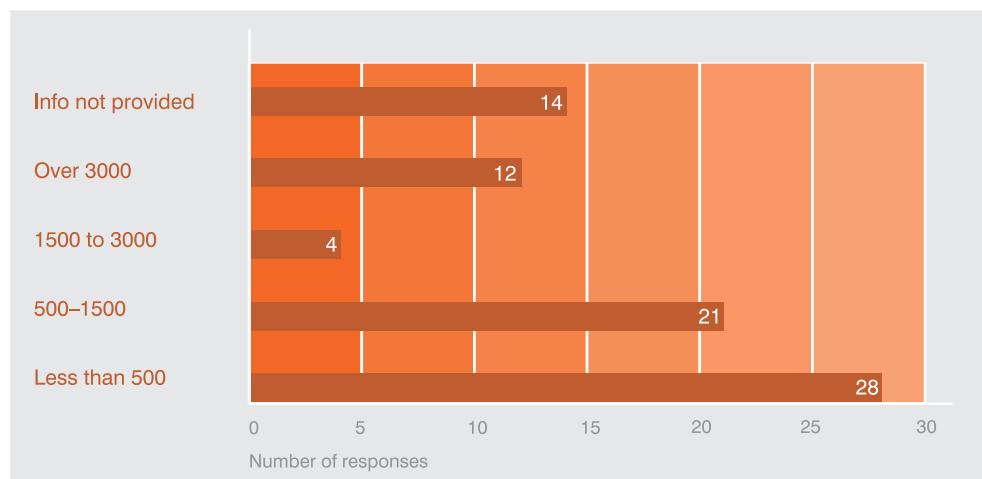
## Response by turnover and number of employees

### Total responses by turnover



Note: Amounts in CZK

### Total responses by number of employees



# Key Findings

Following the review and analysis of response data, the key findings are as follows:

## Positioning of Internal Audit

- 80% of respondents have an Internal audit function located in the Czech Republic (compared to 41% in 2003 and 36% in 2001).
- 82% of respondents believe that the function has sufficient status within their organisation (85% in 2003 and 2001).
- Prevalent Reporting line of Internal audit is to executive management (almost two thirds of respondents).
- Relatively few respondents (21%) have Audit Committees in place that include non-executive directors.

## Internal Audit Quality

- 75% of respondents confirm adherence to IIA standards.
- Only 18% of respondents however believe that they are fully compliant with this standard 1311 on Internal Assessments.
- Only 23% of respondent organisations have either carried out or plan to carry out quality assurance review (QAR) of the Internal Audit function by the end of 2006 (deadline set by IIA Standards).

## Internal Audit Effectiveness

- Evaluating internal control procedures and identifying weaknesses is the primary benefit reported to have been obtained by having an IA function.
- Around 27% of respondents believe that their internal audit function is bringing low benefit at the high cost.
- The primary areas of concern seem to be an insufficient utilisation of supporting information technology; this finding is also confirmed by the reported low usage of electronic working paper systems and computer assisted audit tools and technologies (CAAT).
- There is also a significant response suggesting ineffective communication, a lack of capable resources and not enough focus placed on key business risks.

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Note: Comparatives are provided where comparable figures are available from our 2003 and 2001 IA surveys.



# PwC Point of View

The survey revealed three key issues that IA departments in the Czech Republic face today:

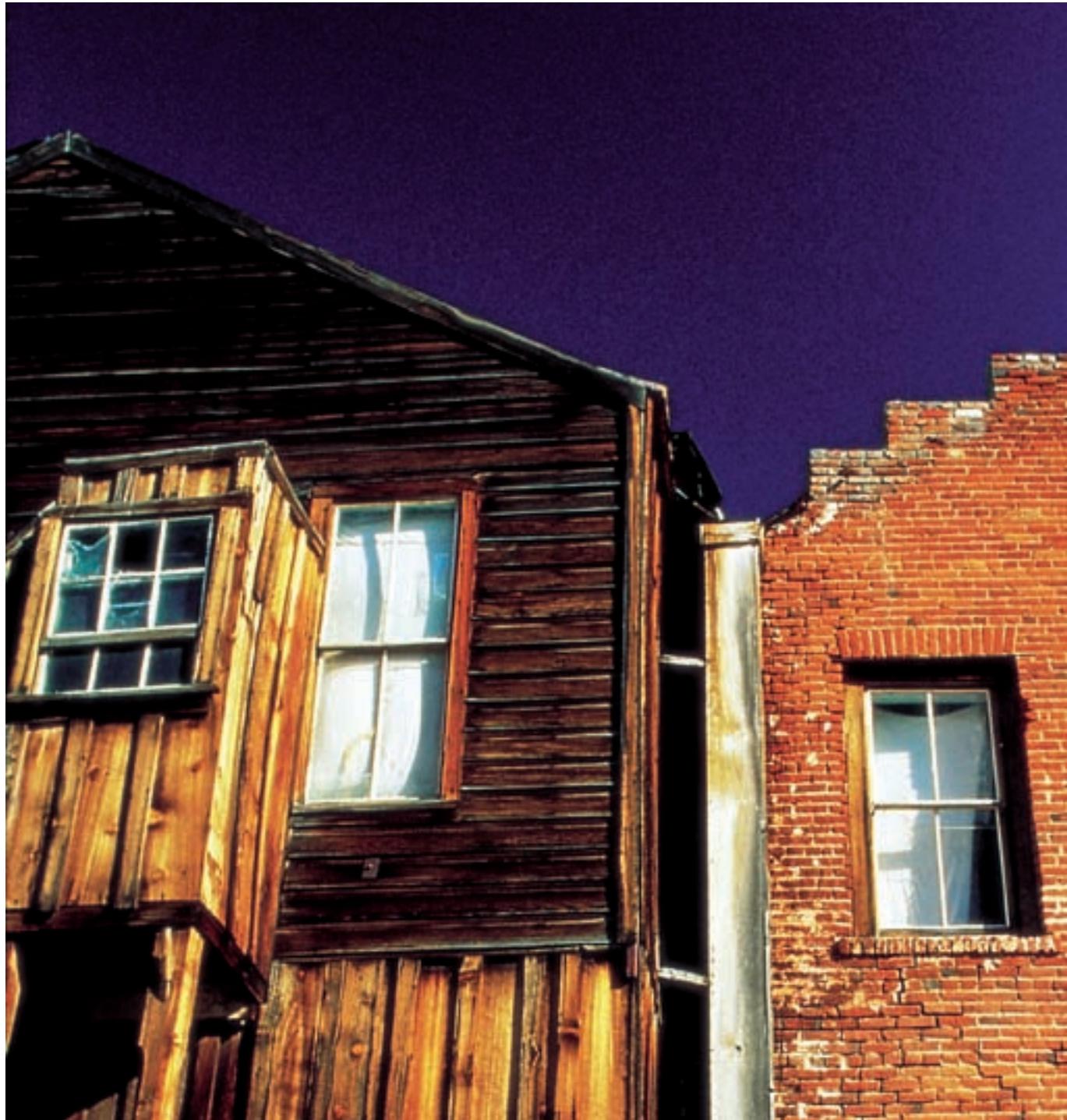
- **Insufficient Independence** – Prevailing reporting line to executive management (almost two thirds) and low number of Audit Committees with non-executive directors (only 21%).
- **Ineffective working practices** – Insufficient utilisation of supporting information technology and ineffective communication seem to be common issues in many IA departments.
- **Lack of focus on Quality** – Compliance with IIA standards on Quality (both 1311 Internal Assessments and 1312 External Assessments) scored very low in the survey (18% and 23% respectively).

## Conclusion

In spite of changes in the world of internal audit that we can see in the Czech Republic, many organisations still seem to see it as necessary overhead, rather than as a means to initiate change and create value. On the contrary, many organisations with a western world view see it much more as a function that could and should deliver efficiency, effectiveness, and strategic value.

However, achieving these benefits requires the investment first – investment in internal audit human resources, processes and infrastructure.

We believe that an external Quality Assurance Review gives you an excellent opportunity to attract the attention of key stakeholders and enhance the strategic performance of Internal Audit.

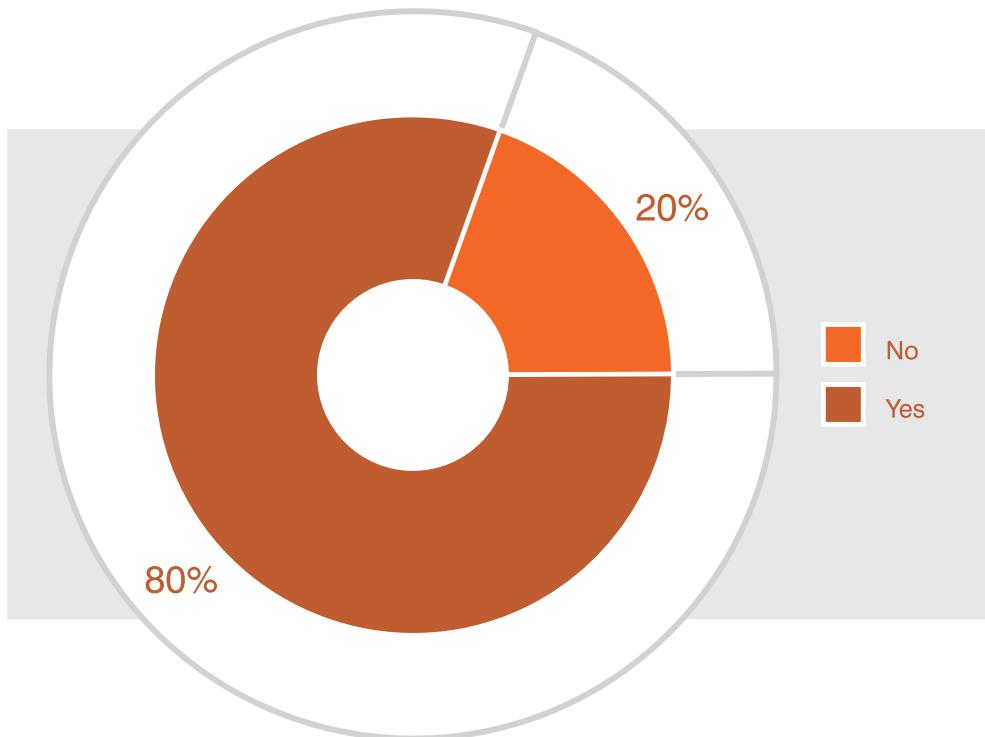




# Data Analysis

# Organisations Without an IA Function

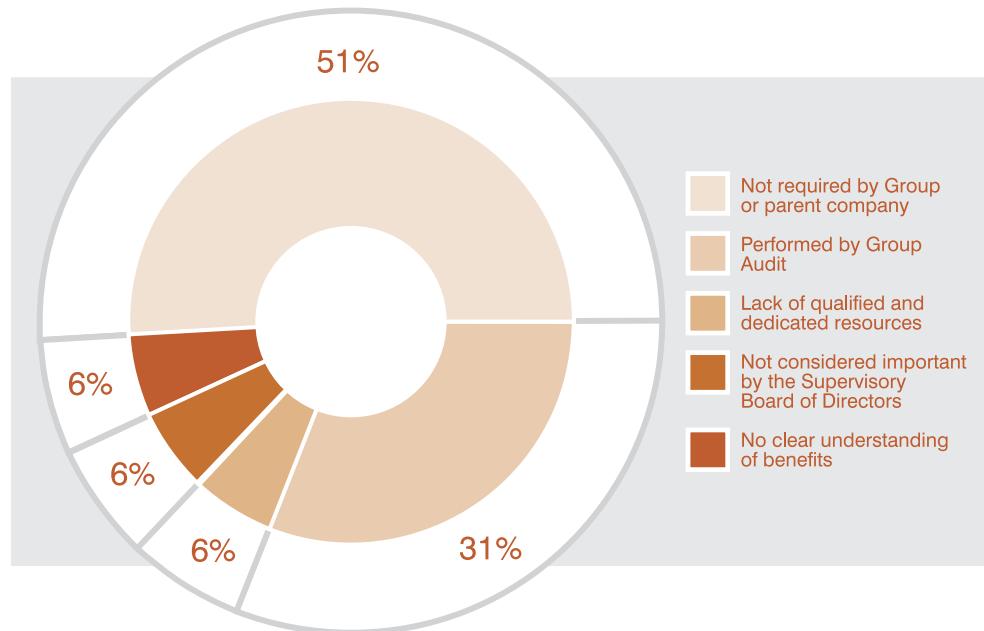
Percentage of organisations with an IA function out of the total number of responses



## Commentary

80% of the organisations that responded to the survey have an IA function located in the Czech Republic (41% in 2003, 36% in 2001). The lowest number of respondents having an IA function came from general manufacturing, especially the automotive industry.

What is the main reason the organisation does not have an Internal Audit function in the Czech Republic



#### Commentary

- The primary reason for not establishing an Internal Audit function appears to be because its establishment is not required by the Group or Parent company.
- The second most common reason is that all IA activities are carried out by the group audit.
- No single respondent answered that lack of available funds is the reason for not establishing an IA function.

Are there any future plans to establish an Internal Audit function?

No short-term plans to establish	81%
Yes – Currently establishing this year	6%
Yes – Considering and expect to establish next year	13%
Yes – Considering only	0%

#### Commentary

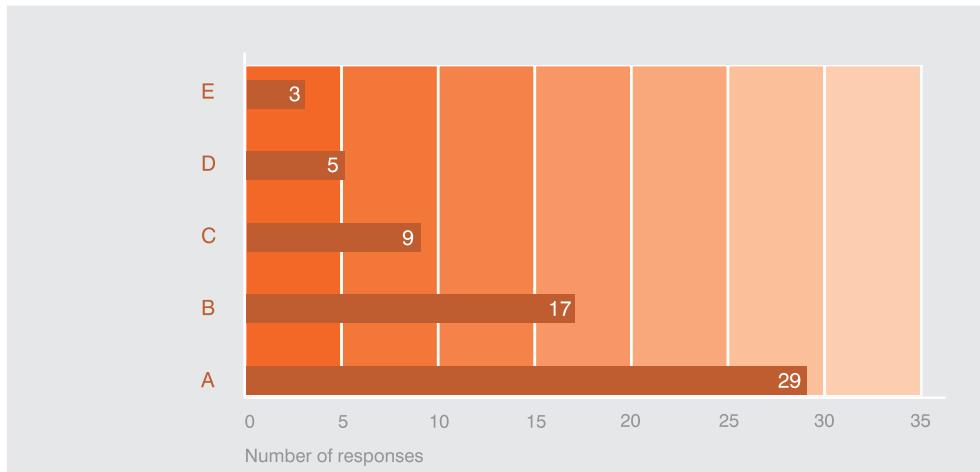
81% of organisations without an Internal Audit function do NOT intend to establish an IA function for their Czech operations in the short-term.

However, 19% of these “no IA” organisations are considering establishing an IA function in the near future.

# IA Organisation

## Headcount of Internal Audit group

### Number of responses by size of the group



### IA size Group Description

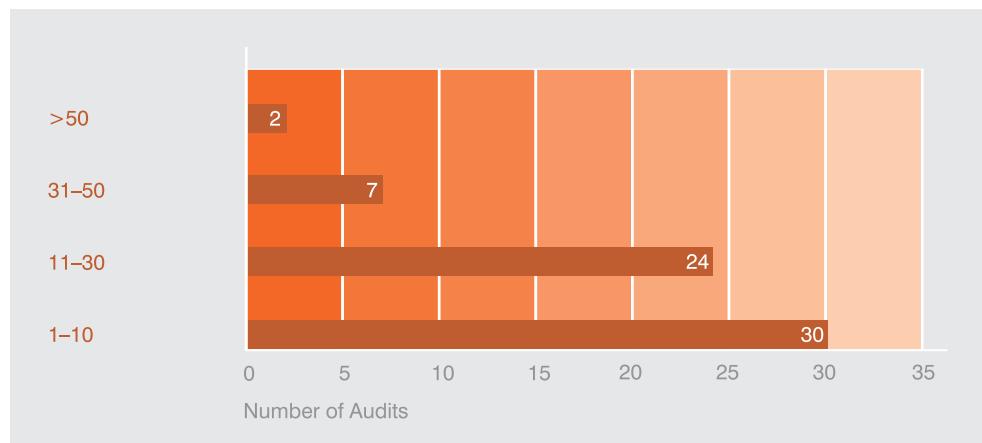
A	1 person
B	2–3 persons
C	4–5 persons
D	6–10 persons
E	Over 10 persons

### Commentary

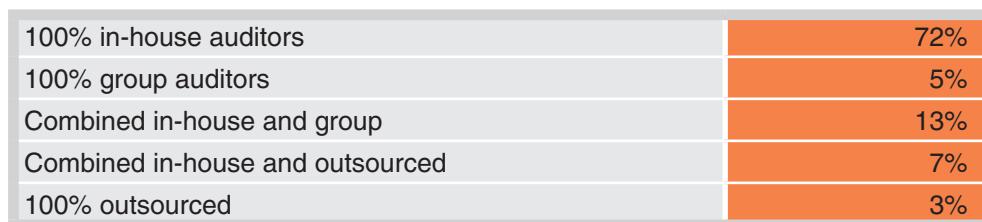
- Most of the IA groups are very small. Almost half of IA departments that responded are represented by a single auditor and another 40% have an IA group of between 2 and 5 persons.
- The number of audits follows the similar pattern and about half of the IA groups carry out less than 10 audits annually.

### Number of audits completed annually

#### Number of responses by number of audits



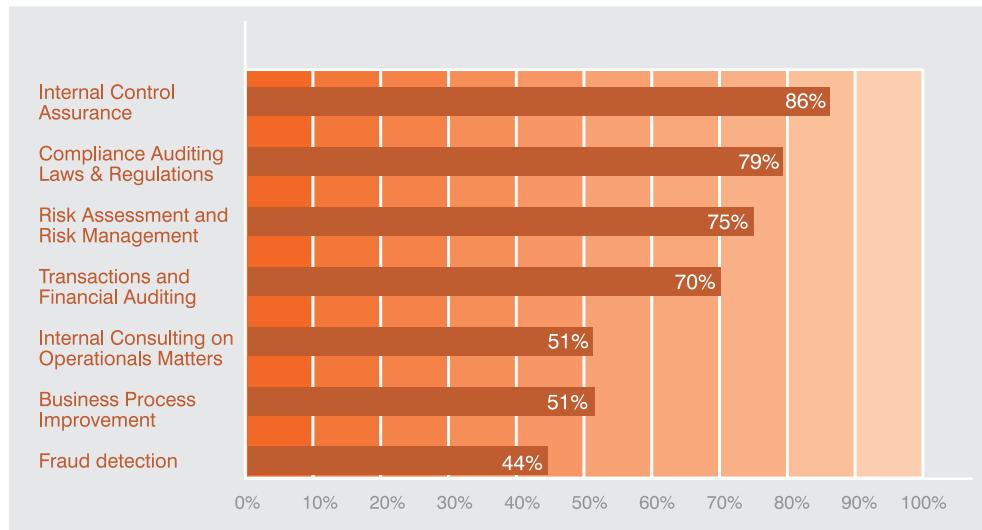
### Who performs internal audit work for operations within the Czech Republic?



#### Commentary

- The majority of audit activities are completed by the Czech in-house function.
- Group auditors are involved in about 20% organisations that responded (either exclusively or in combination with the local function).
- Specialist 3rd party providers are used by around 10% of the respondent organisations.

## What is it the functional focus of internal audit?



### Commentary

- The key focus of internal audit functions (80–90%) is Internal Control Assurance and Compliance Auditing.
- The majority of IA groups (70–75%) are also involved in Risk Assessment/Management activities and cover the areas of basic transaction and financial auditing.
- Business Process Improvement and Operational Consulting are part of the scope in about half of the respondent organisations.

### Who does Internal Audit Director report to?



Note: Organisations from Public Sector were excluded from this analysis as IA typically reports to Public Entity Official given by law (Mayor, Minister etc).

### Commentary

President/CEO or Management Board are most likely to hold responsibility on behalf of the IA function.

Audit Committee/Supervisory Board responsibilities for IA accountability have been established by at least 26% of respondent organisations.

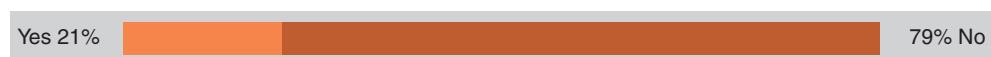
### Does a mission statement (internal audit charter) exist?



### Commentary

95% of respondents confirmed having put a mission statement in place.

### Is an Audit Committee in place which includes non-executive directors?



### Commentary

Relatively few respondents have Audit Committees in place that include non-executive directors.

### Does your IA function have sufficient status within your organisation?



### Commentary

The IA function seems to be well positioned in most of the organisations. Only 18% of respondents believe that their Internal Audit function has a less than sufficient status within their organisation.

# Expectations

What are the most important contributions made to the organisation by IA last year?

Evaluated internal control procedures and identified weaknesses	55%
Completed a risk assessment for the organisation	15%
Improved operating efficiency	11%
Established compliance with organisation policies	10%
Contributed to the implementation of Sarbanes-Oxley act regulations	3%
Identified fraud	2%
Other	4%

## Commentary

- Evaluating internal control procedures and identifying their weaknesses are the most cited contributions of the IA function and the primary benefit being obtained. Potential benefits associated with a risk assessment for the organization are being obtained by 15% of the organisations.
- Only 10% of the IA functions found benefit in establishing compliance with organisation policy and procedures, only 11% improved operating efficiency. Minimum respondents reported that identifying fraud was the most important contribution made to the organisation by the IA function.

What has been the main problem of your internal audit function?

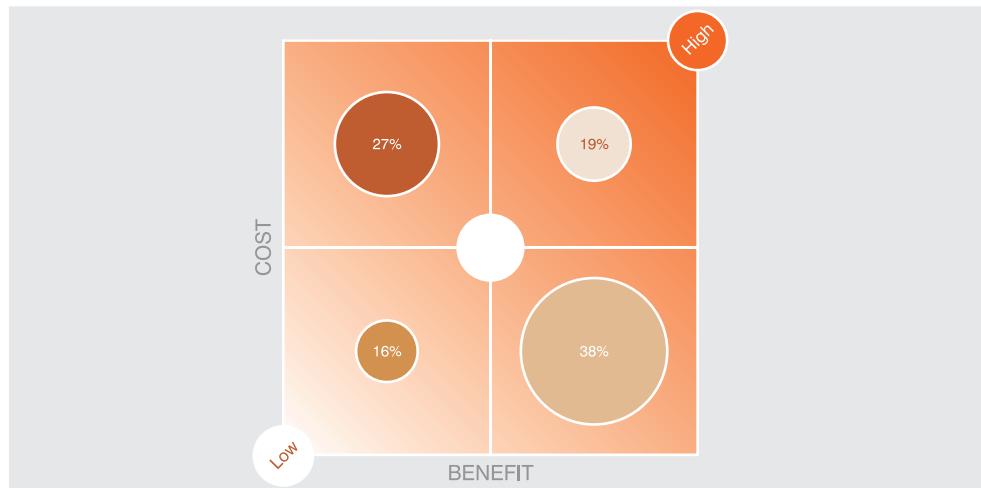
Insufficient utilisation of supporting information technology	25%
Insufficient focus on key business risks and issues	18%
Insufficient communication between internal audit and key stakeholders	16%
Lack of capable and adequately trained resources	16%
Not oriented to seek benefits or operational improvements	4%
Working practices and methodologies are not effective enough	4%
Other	17%

## Commentary

The primary areas of concern about IA function is Insufficient utilisation of supporting information technologies. The other frequent concerns raised were also ineffective communication, lack of capable resources and not enough focus placed on key business risks.

Perception of added value of internal audit compared to its cost

#### Benefit vs. Cost for Internal Audit function



#### Commentary

- 38% of organisations believe that their Internal Audit functions are adding high value at a low cost.
- Around 27% believe that their function is bringing low benefit at a high cost (in 2003 no respondent chose this option).
- The remaining 35% believe that benefits match the cost of IA function (i.e. either high benefit at a high cost or a low cost bringing low benefits).

#### Other topics in which respondents are interested:

- Risk management, including tools for risk assessments
- Tools for electronic working papers
- Control Self-assessment
- Fraud Risks Assessment and Fraud prevention controls
- Sarbanes-Oxley compliance
- IT auditing
- Business Continuity Planning
- Data Management
- Benchmarking
- Performance Metrics

(listed in order from most to least requested).

# Working Practices

Are the audit working papers mainly paper based?



## Commentary

Around 65% of respondents keep only paper based audit working papers as their primary evidence of work performed.

Are computer-assisted audit tools and technologies used to perform audit testing?



## Commentary

About two thirds of the respondents with IA function do not make use of computer-assisted tools and technologies in their audit testing.

Are information technologies the subject of Internal Audit coverage?



## Commentary

The majority of respondents (83%) include information technologies as part of the scope of their Internal Audit activity.

Does internal audit have an effective process of monitoring resolution of observations and recommendations?



## Commentary

The process for monitoring resolution of observations and recommendations is regarded as effective in the vast majority of the responding organisations.

### Is an annual risk assessment prepared?



#### Commentary

For organisations with an IA function, the preparation of a risk assessment is quite common practice. However, the preparation of a risk assessment is only seen by a small number of respondents (15%) to be the key benefit of Internal Audit function.

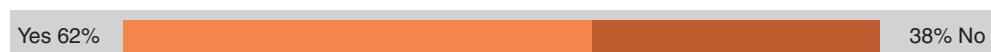
### Is a skill gaps analysis performed on a regular basis?



#### Commentary

Skill gaps analysis being performed at regular intervals is essential for ensuring the proper operation of the Internal Audit function. However, this type of analysis is carried out by only 33% of the respondents to our survey.

### Does an individual training programme exist?



#### Commentary

Existence of individual training programmes for Internal Auditors within IA functions is confirmed by 62% of the survey respondents. However with non existent skill gap analysis (confirmed by only 33% of respondents) money invested in training may not be spent economically.

### Is there a formal system of measuring and evaluation of internal audit's performance?



#### Commentary

Only around 43% of respondent organisations established a formal system of measuring and evaluation of internal audit's performance.

# Internal Quality Programme

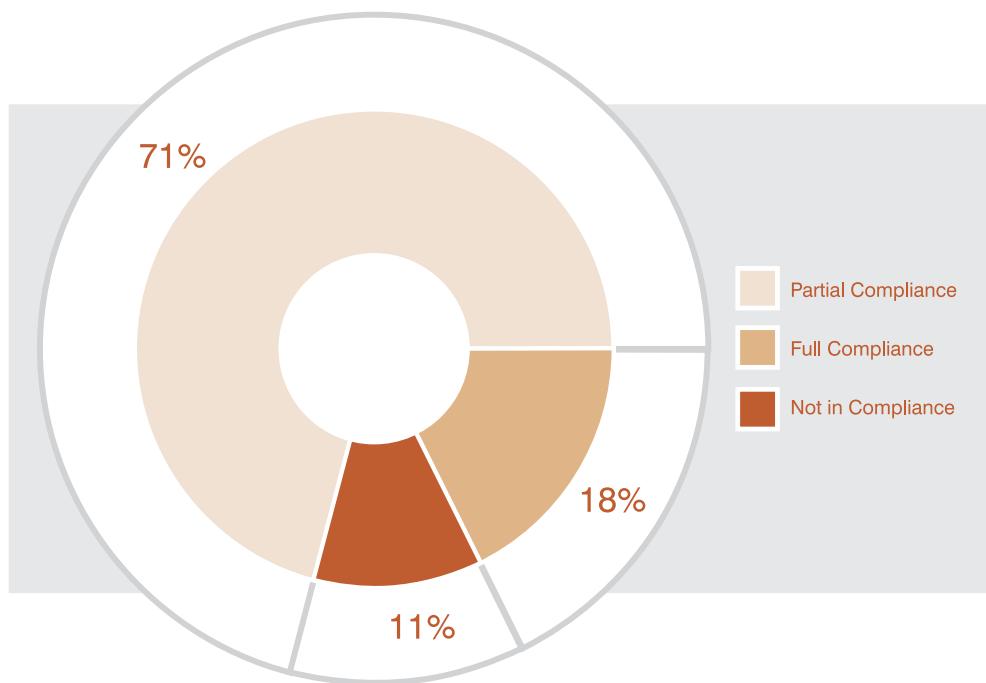
Is the internal audit function following the Standards of the Institute of Internal auditors?



## Commentary

While three-quarters of respondents believe that they follow the standards of the Institute of Internal Auditors, around 25% do not follow those standards or do not know if their practices follow those standards.

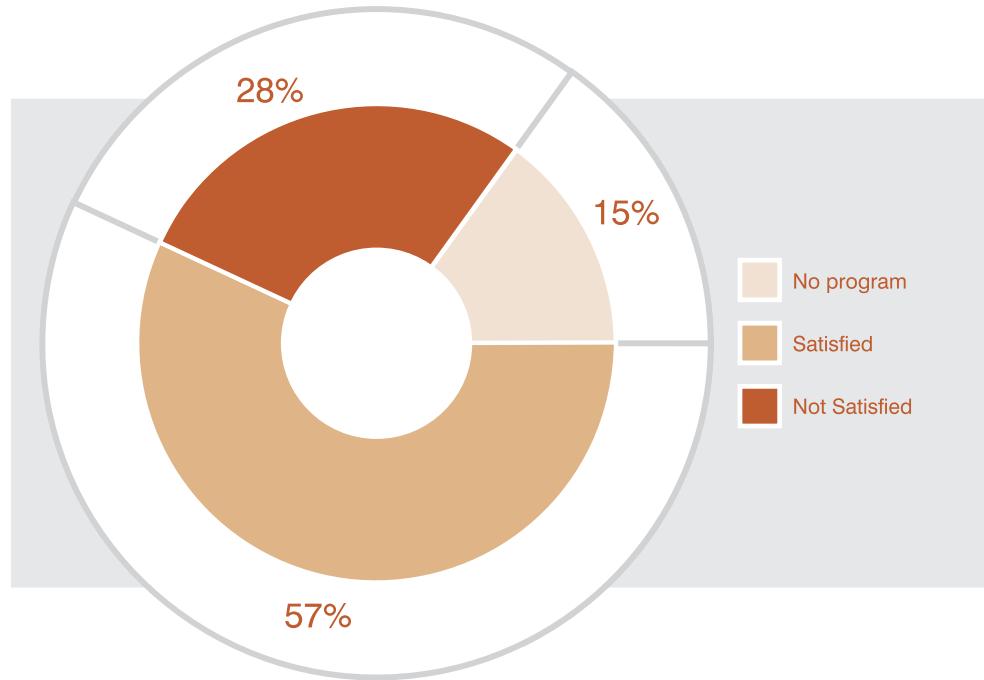
Current level of compliance with Standard 1311



## Commentary

Standard 1311 states that Internal Assessment should include a) ongoing monitoring and b) periodic internal assessment of internal audit performance. Only 18% of respondents believe that they are fully compliant with this standard. More than 80% of respondents considered their internal audit function non-compliant or only partially in compliance.

Satisfaction with current ongoing monitoring programme  
of internal audit

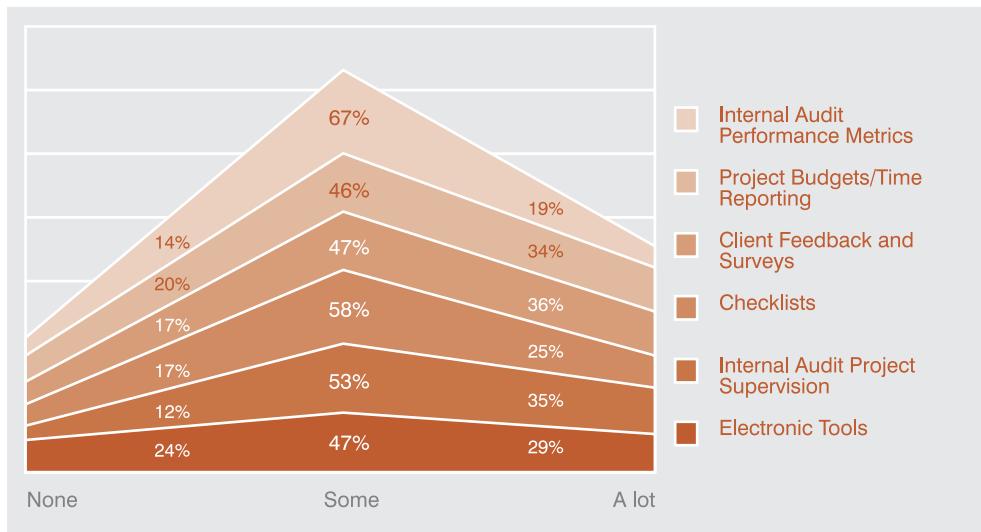


**Commentary**

- Ongoing monitoring is usually incorporated into routine policies and practices used to manage the IA function.
- Around 57% of respondents are satisfied with their current program while more than one quarter is dissatisfied. The balance of the respondents reported to having no ongoing monitoring programme of internal audit.

We can see an interesting contradiction in responses here. On one hand three quarters of respondents claim to comply with IIA standards, yet more than 80% of them admit that they are not in compliance with one of its key standards (1311).

## What benefit is derived from the ongoing monitoring tools listed below?



### Commentary

On average, ongoing monitoring tools seem to bring a certain level of benefit to IA function.

About one-third of respondents manage to derive significant value out of ongoing monitoring tools, the most popular being:

- Client feedback and surveys
- IA project supervision
- Project budgets/Time reporting.

About 20% of survey respondents find no value in ongoing monitoring tools.

## Who performed the periodic internal assessment?

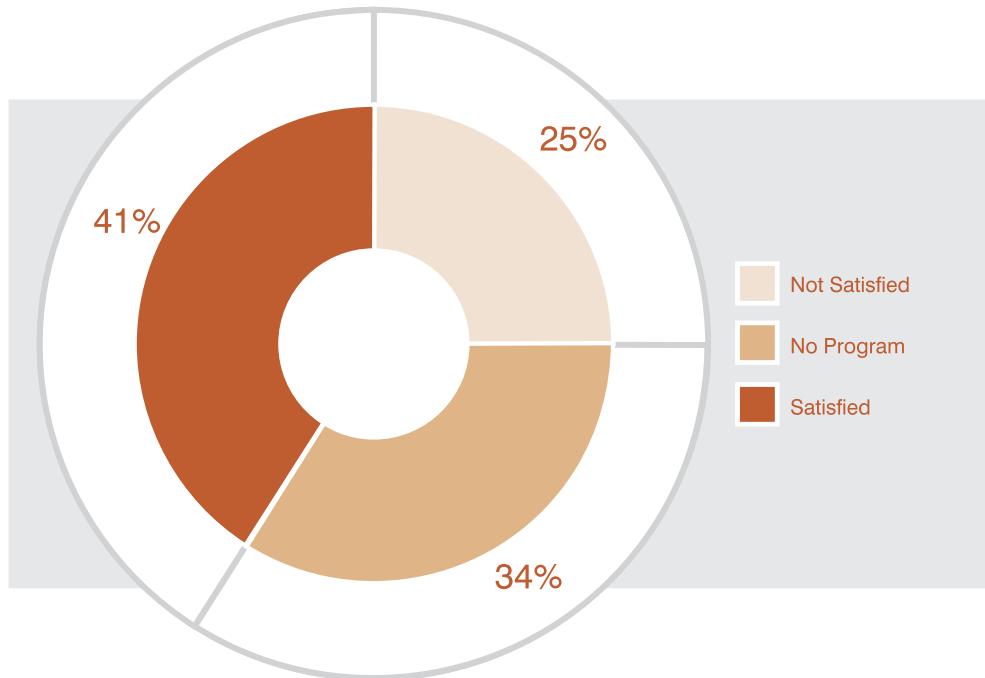
Not performed yet	57%
Members of the internal audit	36%
Group Audit	5%
Certified Internal Auditors	2%

### Commentary

Periodic internal assessments usually represent non-routine special purpose reviews and compliance testing.

The majority of the respondent organisations (58%) have not performed the internal assessment yet. Where conducted, internal assessments are completed mainly by members of internal audit (only 7% has been completed by CIA's or Group Audit).

### Satisfaction with periodic internal assessments of internal audit



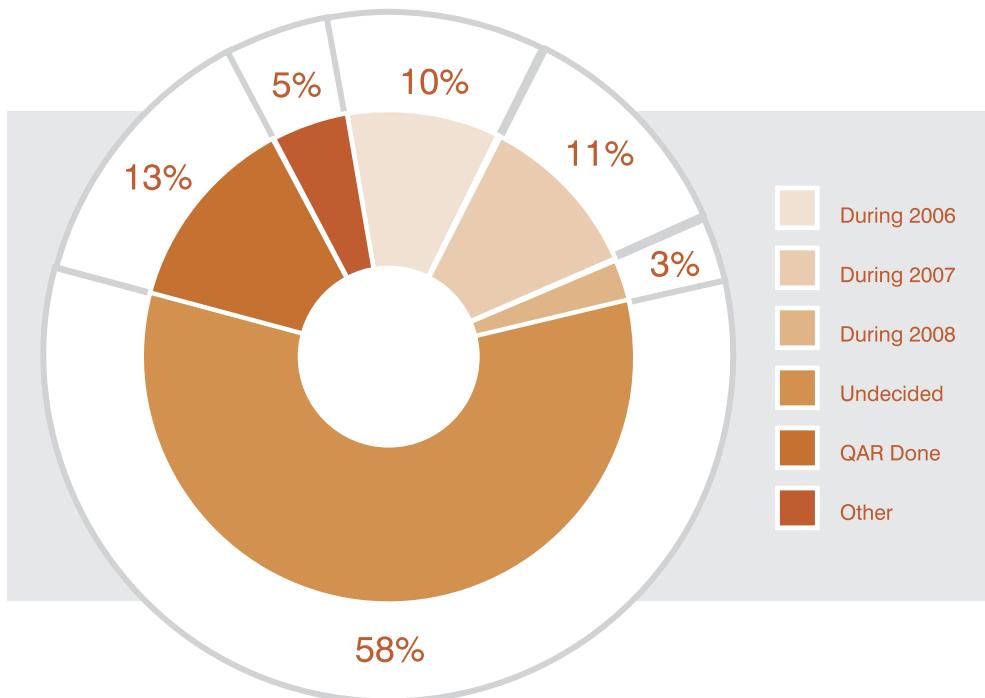
#### Commentary

Around 41% of respondents are satisfied with their current periodic internal assessments while around one-quarter are dissatisfied. The balance of the respondents (more than one third) reported to have no periodic internal assessments of internal audit.

# External Quality Assurance Review

When are you planning on having QAR?

Percentage of companies that completed or plan to have QAR



## Commentary

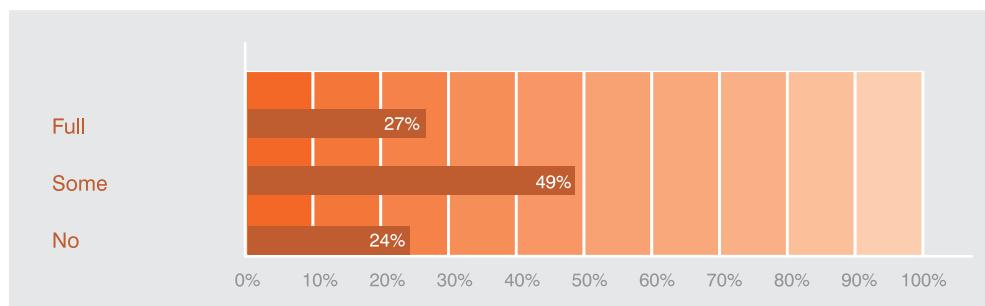
Only 23% of respondent organisations have either carried out or plan to carry out a quality assurance review (QAR) of the Internal Audit function till the end of 2006 (deadline by IIA Standards).

Another 14% of respondent organisations plan to carry out a QAR over the next two-year period.

Around 65% of the responders haven't decided on whether or when to perform an QAR.

Having sufficient information on the purpose and potential benefits of QAR.

Availability of sufficient information on QAR



**Commentary**

Only about one-fourth of the respondents believe they have sufficient information on the purpose and value of the QAR.

More than 70% of the responders have only some or no such information on QAR.

**Do you see QAR as an opportunity to benchmark your organisation?****Commentary**

The opportunity to benchmark the Internal Audit group as part of QAR is seen as a benefit by 85% of survey respondents.

**Do you see QAR as an opportunity to evaluate current performance against stakeholder expectations?****Commentary**

About three-quarters of the respondents saw QAR as the opportunity to evaluate current performance against stakeholder expectations.

**Would you consider performing an internal quality assessment with independent external validation?****Commentary**

Only a small part of respondents (about 30%) would consider an internal QAR with independent validation as an alternative to QAR.

The prevailing preference seems to be conducting full-scope external QAR that can bring additional benefits of benchmarking and external experience.

**Have you estimated the total resource requirements to perform QAR?****Commentary**

Only a minority of survey respondents (15%) have attempted to estimate resource requirements to perform QAR. The number roughly coincides with the proportion of organisations that have already gone through QAR (13%).

The estimates were stated mostly in man-days and ranged between 5 and 80 man-days depending on the size of organisation.





## The Way Forward

# Get Ready for Quality Assurance Review

We believe that an external Quality Assurance Review gives you an excellent opportunity to attract the attention of key stakeholders and enhance the strategic performance of Internal Audit.

An external quality assurance review of an internal audit department can provide a number of significant benefits. With the insights and information gained, an organization can:

- Provide independent assessment that internal audit is complying with globally recognized standards. This is an important factor in the eyes of internal audit's three primary stakeholders:
  - 1) the audit committee
  - 2) senior management
  - 3) the organization's external auditors.
- Affirm that internal audit is serving as a reliable source of information for risk, control and governance within the enterprise.
- Compare the performance of the internal audit group with that of its peers.
- Determine whether internal audit has the right reporting structure, people and skill sets to address enterprise-wide risk and governance issues.
- Assess key stakeholder expectations, e.g., what values they expect to gain from internal audit.
- Determine whether internal audit processes and practices are aligned effectively with stakeholder expectations.
- Explore how to raise the stature and visibility of the internal audit group.

To ensure a successful external quality assurance review and to optimise its value, we recommend the following approach:

- **Commit to quality:** Make a deliberate and documented commitment to quality assurance and improvement.
- **Design and implement a QA programme:** Build a quality assurance and improvement programme consistent with IIA standards, and put it to work.
- **Implement policies and protocols:** Establish appropriate policies, procedures, and controls to enhance quality and ensure conformance with IIA standards.
- **Conduct a quality assurance review:** Schedule and undergo an external quality assurance review with integrated benchmarking and strategic assessment objectives.
- **Correct and enhance:** Implement all corrective actions that are recommended by the external quality assurance review to ensure conformance with IIA standards and enhancements to strategic performance.
- **Assess performance:** Continuously evaluate internal audit's compliance with IIA standards and the function's overall strategic performance.

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