

# INSIGHTS FROM THE EUROPEAN CAE ROUNDTABLE

When 20 of Europe’s leading chief audit executives from ten countries meet together, it’s a safe bet that key insights will be shared on internal audit challenges. That’s exactly what happened in Amsterdam recently, when The European Institutes of Internal Auditors hosted an exclusive roundtable for chief audit executives. Leaders from The Institute of Internal Auditors (IIA) helped facilitate the discussion on current trends facing the profession. The group shared tips and information on numerous topics, but the conversation centred around three main themes: internal audit staffing at global organisations, audit committee roles and expectations of internal audit, and emerging issues in European regulations and directives.

## GLOBAL INTERNAL AUDIT STAFFING

Members of the group had various approaches to internal audit staffing, and the overall consensus was that there is no one “right” way to structure an internal audit function. Decentralised, centralised, and hybrid approaches to staffing can each work well, but each has risks as well as advantages.

With a centralised approach, the danger is that internal auditors will face language or cultural barriers when working away from their home country. Visiting auditors may be viewed as outsiders, without access to the informal network of trusted people who often serve as a resource for internal auditors. Travel schedules for centralised audit functions can sometimes be grueling, resulting in higher turnover rates and hindering auditor recruitment.

Participants stated that various techniques can help with problems arising from centralised staffing. “Guest auditor” programs, rotational programs, and co-sourcing through local consulting firms are often used to address language and cultural challenges. One participant advised, however, that when working with co-sourcing partners in a foreign environment, it is essential to maintain a stable relationship with a team of local auditors who know the organisation’s operations and personnel. When there are frequent changes in co-sourcing partners, language and cultural barriers may

be overcome, but the audit team may still be viewed as outsiders, without the contacts and internal perspectives that can be invaluable for efficient and effective internal auditing.

With a decentralised approach to staffing, other problems were reported. A lone auditor based in a remote location may often feel isolated, and he or she may be cut off from the knowledge sharing and training opportunities that occur when auditors work from a central location. Communications within the internal audit group may be hampered by language or time zone barriers, further increasing feelings of isolation. In some cases, auditor independence can become an issue when auditors in remote locations begin to identify more with local management than with other members of the internal audit staff. Language skills might be a barrier to promotional opportunities in other parts of the organisation, and auditors without clear career paths and promotional opportunities may leave the company, taking valuable organisational knowledge and skills with them when they leave.

With decentralised staffing approaches, therefore, it is essential to concentrate on communications within the internal audit group. Auditors must be made to feel that they are part of a team working towards common goals, sharing tips and techniques freely across locations.

One of the most common models for global staffing is a hybrid approach, where auditors working from headquarters work together with auditors based in foreign locations. The hybrid approach can help ensure that audits are performed consistently throughout the organisation, and it can help address independence challenges associated with decentralised staffing approaches. Home office auditors may be able to supply specialised skills that are not available at smaller remote locations, while local field auditors or “guest auditors” have the local contacts, language abilities, and knowledge of local customs that can help assure a smooth internal audit. “We all have different structures, but we all make it work,” stated one participant. “We all need a good mix of skill sets, and we all need to address language issues. Managing internal audit from a central location without local strength won’t work. But if the internal audit function is completely decentralised, that doesn’t work well either. Whichever approach you follow, you need to ensure that each internal auditor has a defined career path and that they work together as a unified team.”

## AUDIT COMMITTEE ROLES AND EXPECTATIONS OF INTERNAL AUDIT

Roundtable participants stated that some audit committees are still hoping for “no surprises,” both when considering risks and controls and when evaluating the internal audit function itself. Audit committees are looking for specific assurance on risk management and on the internal control system, and internal audit needs not only to furnish information to the committee, but also to help analyse and interpret key information so that the committee has a clear understanding of risks, controls, and the role of internal audit within the organisation.

IIA President and CEO Richard Chambers pointed out that there is often a gap between audit committee expectations

“If surveyed today on how well internal auditing is meeting its needs and expectations, my audit committee/executive management would probably rate their overall satisfaction...”

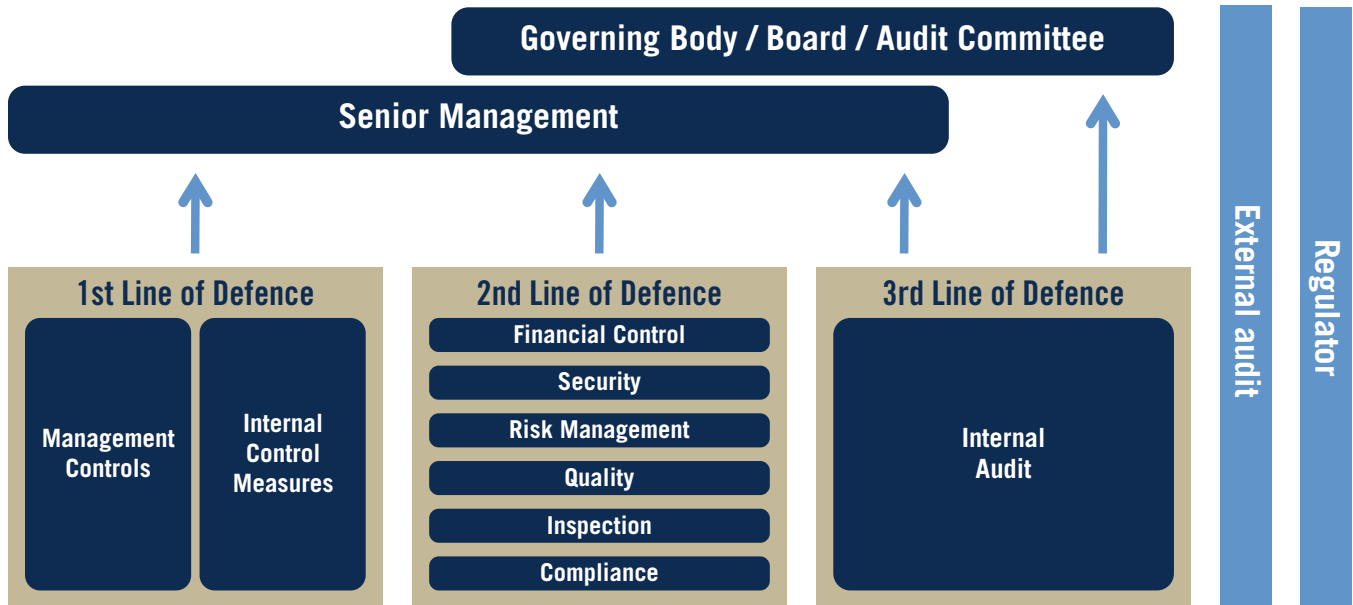
	Audit Committee	Executive Management
Unacceptable	0.0%	0.4%
Poor	0.4%	1.9%
Acceptable	16.1%	25.9%
Good	57.6%	57.8%
Outstanding	25.9%	14.0%

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and internal audit resources. A survey by The Institute of Internal Auditors’ Audit Executive Center indicates that most chief audit executives believe their audit committees and executive management would rate their overall satisfaction as good to excellent; however, other new surveys indicate this assumption may not be correct. A new survey from Ernst & Young indicates that only 59 percent of stakeholders would rate their internal audit function as “very effective” or even “somewhat effective.” In two unrelated studies by The IIA Research Foundation, only 38 percent of executive stakeholders surveyed stated that they believe internal audit frequently delivers insight, and almost half of stakeholders stated that they do not believe internal audit excels at developing talent for leadership positions.

Audit committee expectations of management, internal audit, and other groups of risk and control professionals may sometimes become blurred, leading to confusion about which parties are responsible for specific internal control

## The Three Lines of Defence Model



duties. It is essential for audit executives to be able to articulate these issues clearly and to address them in a way that helps assure there are neither “gaps” in controls nor unnecessary duplications of coverage.

The participants exhibited strong conceptual support for the Three Lines of Defence model that delineates responsibilities over risk management and internal control, in which management and control measures serve as the first line of defence; oversight, evaluation, and assessment by groups such as compliance officers, risk managers, financial control activities, and quality inspectors form the second; and independent assurance by internal audit is the third line of defence. Each of these three “lines” plays a distinct role within the organisation’s wider framework of governance, and there was general agreement that the Three Lines of Defence model effectively represents the roles of each party

in the governance process, enhancing communications on risk management and control by clarifying essential roles and duties.

### EMERGING ISSUES IN EUROPEAN LEGISLATION AND DIRECTIVES

The group also focused on emerging issues in European legislation and directives. The European Commission is the primary legislator in Europe, its directives are applied across Europe through national legislations. Although specific legal requirements may vary by country, the source of legislation on corporate governance issues is often found at the European level and within the non-mandatory corporate governance codes that cross national boundaries; therefore, audit executives from across Europe shared similar concerns regarding many legislative issues. Regulation on bribery, privacy, and

many other issues often have impacts that span across national boundaries, further complicating the compliance picture.

Participants stated that, in general, the trend toward increased regulation and oversight is starting to meet resistance, especially in the area of corporate governance. Inflexible regulatory requirements may in some cases actually do more harm than good. For example, in the highly regulated financial services industry, audit executives must deal with requirements for specific types of audits that must be performed on a regular schedule. True risk-based auditing may not always be fully possible when elements of the annual audit plan are dictated by regulatory expectations or requirements.

“Because of the growing backlash against inflexible regulation, governance requirements are increasingly being built around “comply or explain” provisions which state that organisations should either comply with specific best practices or explain, through disclosures, why they have chosen not to comply,” said Carolyn Dittmeier, president of the ECIIA and chief audit executive of the Poste Italiane. “For example, a governance code may state that if internal audit is not present in an organisation, management should be required to explain why internal audit is not considered necessary in their organisation.”

A “comply or explain” approach provides needed flexibility, but the participating audit executives generally seemed to believe that when the “or explain” option is chosen, simple explanations are insufficient: Explanations regarding non-compliance should be detailed and specific enough to fully illustrate why any basic element of strong governance is not in place.

Even where internal audit is in place, current governance codes are often inadequate to assure audit effectiveness.

Compliance with governance codes is often voluntary, and although about 90 percent of corporate governance codes require or recommend having an internal audit function, few of the codes include specific requirements regarding internal audit effectiveness.

“Because stakeholders need specific assurance regarding risks and controls, a better approach might be to comply and explain,” stated Dittmeier. Future governance codes may one day require organisations to explain, for example, whether or not the internal audit function has been subject to an independent quality assessment or whether it is required to comply with recognised professional standards such as the *International Standards for the Professional Practice of Internal Auditing*.

## THE CALL FOR ADVOCACY

What should The IIA’s role be in these initiatives? According to one participant, the Institutes should supply “information, advocacy, and guidance.” In our increasingly complex environment, the audit executives saw a clear need for enhanced advocacy efforts, both by internal auditors and by The IIA. The IIA should provide information and guidance not just to internal auditors and audit committees, but also to the legislators, regulators and other groups helping to shape our profession.

Chambers stated that historically, global advocacy, while important, had not been a top priority for The Institute of Internal Auditors; however, recognising the long-term strategic impact advocacy has on the vibrancy, resiliency, and relevance of the internal audit profession, The IIA’s Board of Directors is now infusing significant attention towards global advocacy.

The Institutes, the regional bodies (e.g. ECIIA), and individual audit executives can be effective in influencing upcom-

ing legislation, regulation, and governance codes, both in Europe and in the rest of the world. Because legislation and regulation have a profound impact on our organisations, it is essential that we work together to assure that upcoming legislation and directives are both flexible and effective, as well as making good sense from a governance perspective.

Participants in this year's European CAE Roundtable were united on one other point: Networking and information sharing can be essential for assuring internal audit's long-term success and relevance. "We all face the same types of challenges," stated one participant. "The European CAE Roundtable helped us 'connect the dots' and share our strategies on some of the toughest issues we are facing today."

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The European Institutes of Internal Auditors and the The IIA's Audit Executive Centre would like to extend our sincere thanks to the chief audit executives of the following organisations for their participation in our first European CAE Roundtable.

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- Kingfisher
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- Nokia
- Orkla
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- Santander
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