



# Good Practices of the Audit Committee

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# Overview

- Audit Committee's
  - Core responsibilities are Expanding
  - Must cope with the complex challenges facing 21<sup>st</sup> century organizations
  - Need strong and capable leaders
- 5 Things the Audit Committee is Unlikely to Hear from the Chief Audit Executive
- 10 Questions the Audit Committee Should Ask the Chief Audit Executive

# The Audit Committee's Core Responsibilities Are Broader Than Ever

## Oversight of:

Financial reporting and internal control  
over financial reporting

External auditors

Internal auditors

Establishment of whistleblower  
procedures

Risk management, legal and  
regulatory compliance

# 21<sup>st</sup> Century Organizations Face Complex Challenges



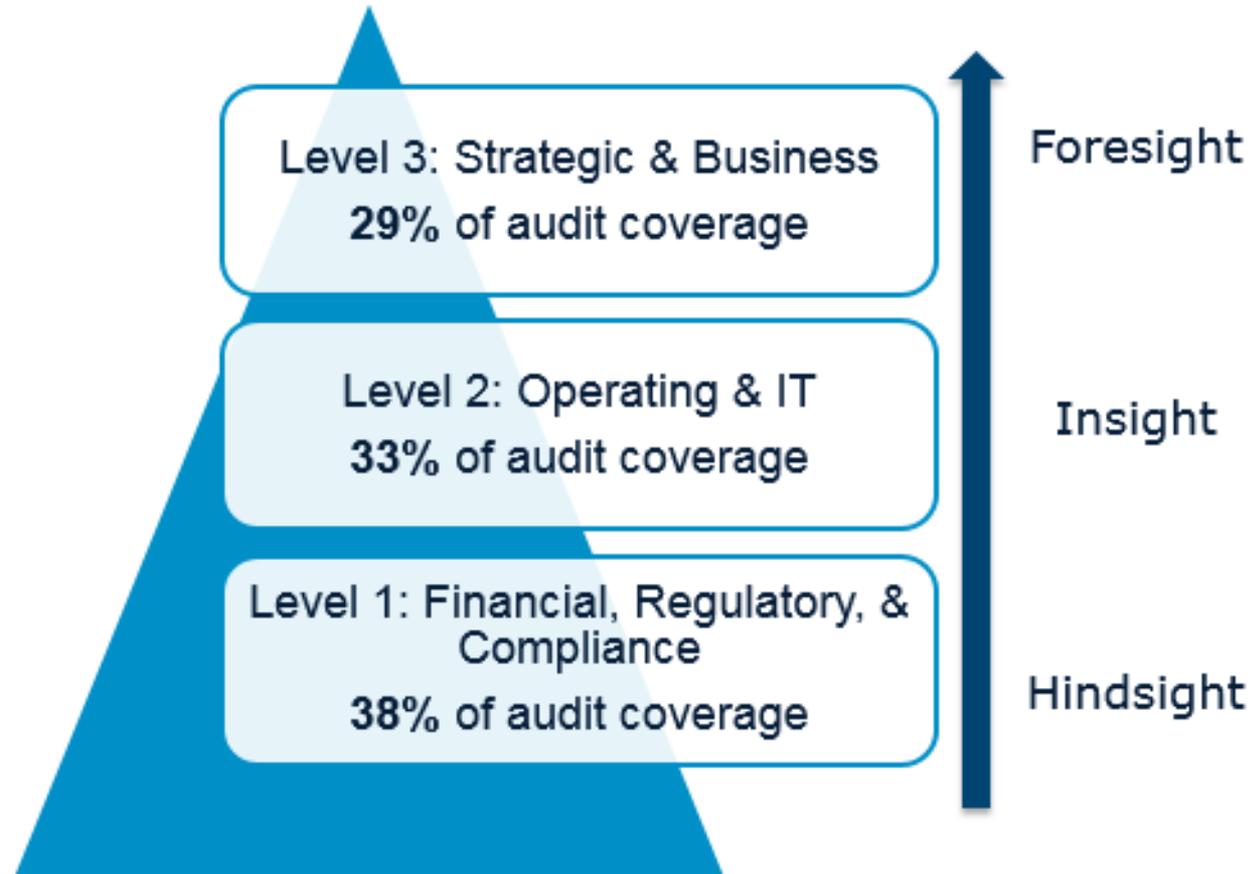
# Organizations Face a Volatile Risk Landscape

- Risks can materialize with little or no warning
- Trust and value can evaporate
- Boards, management, and auditors must be attuned to changes
- Internal auditors must “audit at the speed of risk”



# Unlocking the Value of Internal Audit

**The Paradox of Structural Expectations for Internal Audit:** Base level coverage often provides the lowest perceived value



# Unlocking the Value of Internal Audit

- Internal audit increasingly is called on to help improve strategic areas such as risk management
- Recommendations:
  - Ensure the internal audit plans are focused on the most significant risks to the business, including strategic and operational risks
  - Clarify internal audit's role in connection with risk management (providing assurance, not managing risks)
  - Expect internal audit to “audit at the speed of risk”

# Culture Is Increasingly the Culprit in Organizational Debacles

## THE WALL STREET JOURNAL Volkswagen Blames 'Chain of Mistakes' for Emissions Scandal

44%

WOLFSBURG, Germany— Volkswagen AG on Thursday blamed a damaging emissions crisis on a “chain of mistakes” that began with the company’s diesel push into the U.S. in 2005 and “culture of tolerance” for rule-breaking that allowed the deception to continue for a decade.

## FORTUNE Toshiba’s accounting scandal is much worse than we thought

24%

The company has disclosed by just how much it overstated its profits. Toshiba admitted on Monday that it had overstated its profits by nearly \$2 billion over the past 7 years...

## The New York Times FIFA Corruption: Top Officials Arrested in Pre-Dawn Raid at Zurich Hotel

18

indicted

ZURICH — Swiss authorities began a new series of pre-dawn arrests Thursday in the broad investigation, led by United States officials, into corruption in international soccer. Sixteen people were expected to be charged by day’s end, law enforcement officials said, nearly doubling the size of an already huge case that has upended FIFA, soccer’s multibillion-dollar governing body.

## THOMSON REUTERS Hertz CEO steps down after accounting errors

28%

Mark Frissora has resigned as chief executive of Hertz Global Holdings Inc, citing personal reasons, as pressure from investors mounts following a series of accounting errors.



# CEOs and CFOs See Culture As Critical

- Over 90% believe culture is important
- 92% believe improving their culture would improve value of the company
- Over 50% believe culture influences:
  - Productivity
  - Creativity
  - Profitability
  - Firm value and growth rates
- **Yet...only 15% believe their corporate culture is where it needs to be**

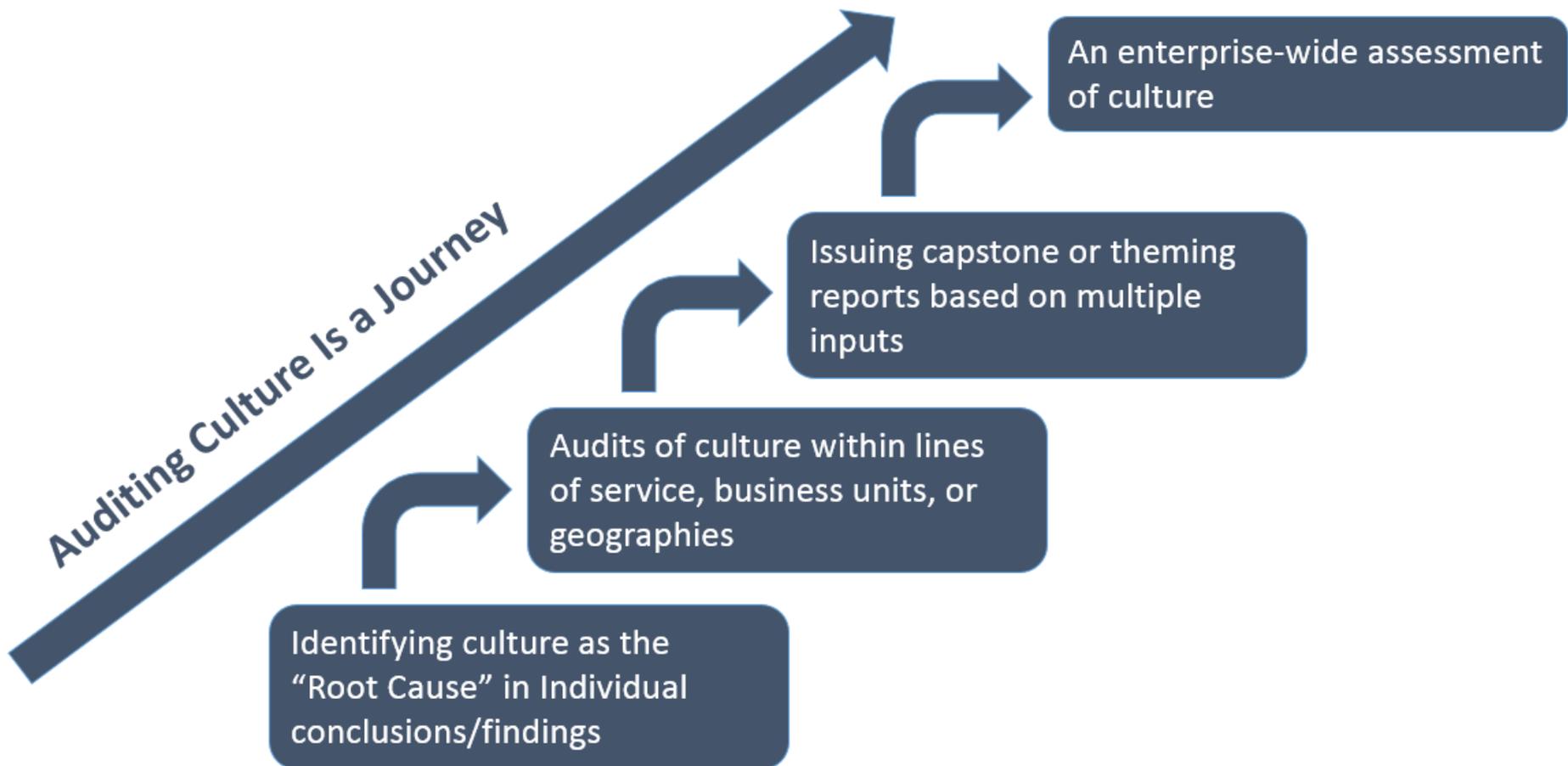


# The “Root Cause” Can Often Be Culture

- It is tempting to only look at specific issues and how to correct
- Did certain behaviors cause the problem?
- Is culture a fundamental root cause?
  - When controls fail
  - When risks aren't managed
  - When regulations or laws are violated



# Unlocking the Value of Internal Audit



# Unlocking the Value of Internal Audit

- Recommendations:
  - Seek internal audit's assessment of culture
  - Ensure internal audit has necessary resources and skills for the task
  - Reinforce internal audit's stature within organization and accountability to audit committee
  - Define reporting relationship that maximizes objectivity

# Technology Risks Are As Complex As Ever



36% of Corporate Directors surveyed say they are not satisfied with the quality of information provided by management on cybersecurity and information technology risk.

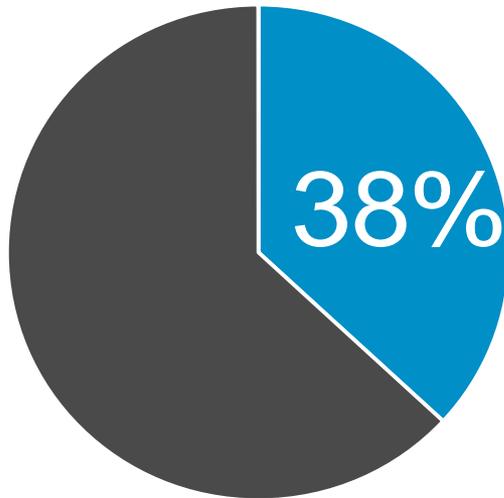
- Technology risks:
  - Rank among the top concerns of corporate directors
  - Integrated into the fabric of the business
  - Difficult to identify and mitigate

# Technology Risks Are As Complex As Ever



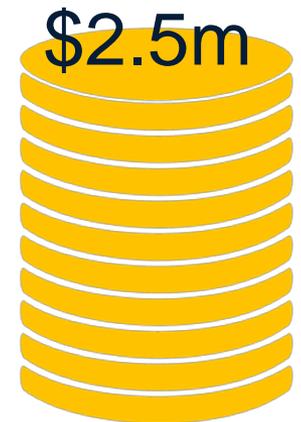
**“Many executives are declaring cyber as the risk that will define our generation.”**

— Dennis Chelsey,  
Global Risk Consulting Leader, PwC



Year-over-year increase in detected information security incidents

Average total financial loss due to security incident

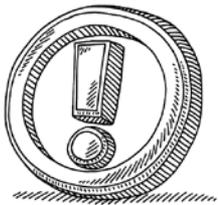


# Unlocking the Value of Internal Audit

- Bolstering cyber preparedness by coordinating with the board and management on:
  - **Protection:** Provide a holistic approach to identify vulnerabilities; assurance over IT governance
  - **Detection:** Work with IT to develop key risk indicators; ensure adequate and effective controls
  - **Business continuity:** Assurance that plans are effective, efficient, and enterprise-wide
  - **Crisis management and communications:** Help develop plans or provide assurance
  - **Continuous improvement:** Help evolve and improve strategies

# Regulators Are Raising the Bar

Regulation's impact is growing



**83%**

said the impact of regulation on their organization is more significant compared to five years ago.



**36%**

...and regulations lack consistency and collaboration

said the approach to regulation between different regions in which their organization operates is not consistent.



**48%**

said that different regulators collaborate with each other ineffectively.

# Regulation Is Essential, but Comes at a Cost

Regulation impacts costs, growth,  
and innovation



**80%**

said regulation has a significant impact on their organization's cost of doing business.



**66%**

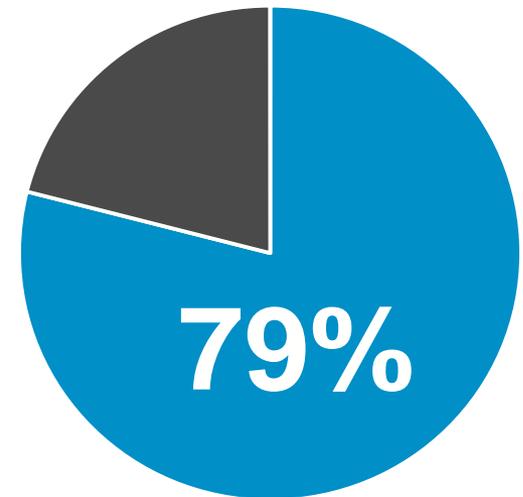
said it has a significant impact on their organization's opportunity to grow.



**63%**

said it has a significant impact on their organization's opportunity to innovate.

...and regulations remain complex.



said the regulation impacting their organization is complex or very complex.

# Unlocking the Value of Internal Audit

- Leverage internal audit's deep understanding of the regulations and potential risks to the organization
- Charge internal audit with monitoring risks from emerging regulations and ensuring organization's capabilities
- Mandate internal audit's ability to audit risk and compliance

# Tension for the Chief Audit Executive (CAE)

CAE is an important member of the company's management team

...while the CAE is also responsible for reviewing management's conduct and performance.

# Unlocking the Value of Internal Audit

- CAE should report functionally to the audit committee and administratively to the CEO or other executive.
- To ensure internal auditor's objectivity, the audit committee should be involved in:
  - Developing audit plan
  - Determining budget and resources
  - Hiring and termination of the CAE
  - Performance review of the CAE
  - Compensation of the CAE

# Audit Committees Need Strong and Effective Leaders



# Five Attributes of Extraordinary Audit Committee Members

1. Courageously independent
2. Professionally skeptical and intellectually curious
3. Deeply experienced
4. Approachable relationship builders
5. Risk-centric strategists

# What the CAE Won't Tell the Audit Committee



# What the CAE Won't Tell the Audit Committee

1. The risk assessment I present to you is sometimes limited because I don't have the right staff with the right skills and expertise in some areas.
  - Audit coverage is driven by resources rather than risks.

# What the CAE Won't Tell the Audit Committee

2. Identifying emerging risks is one of the biggest challenges we face.
  - Auditing at the “speed of risk.” Understanding that many risks have ripple effects that can impact in unanticipated ways.

# What the CAE Won't Tell the Audit Committee

3. We want to provide assurance on strategic risks, but we are bogged down in tactical financial and compliance audits.
  - The paradox of structural expectations

# What the CAE Won't Tell the Audit Committee

4. We are as important to you as the external auditors.
  - Internal auditors identify the root causes of issues and help the organization to operate more efficiently and effectively.



# What the CAE Won't Tell the Audit Committee

5. Within an effective governance structure, internal audit is the audit committee's only independent line of defense for effective risk management and control.
  - While there may appear to be overlap with certain control functions like Compliance and Financial Control, internal auditors should be independently evaluating these functions, providing assurance they are being effectively executed.

# Parting Thoughts



# 10 Questions the Audit Committee Should Ask the CAE

1. What is the internal audit coverage of the organization's risk management governance processes?
2. How responsive to change and flexible is internal audit's risk-based audit plan?
3. How does internal audit use technology to enhance its auditing and monitoring activities?
4. What is the strategic vision and plan for internal audit?
5. What perceived value does the organization receive from its internal audit activities?

# 10 Questions the Audit Committee Should Ask the CAE

6. How do we strengthen communications and relationships between internal audit and the audit committee?
7. How does internal audit ensure that its activities are in full compliance with *The IIA Standards*?
8. How does internal audit acquire and develop top talent for the organization?
9. What types and levels of training are necessary for internal audit to accomplish its mission?
10. Does internal audit periodically inventory and assess its skills to identify gaps and how are they being addressed?

# Thank You!

## The Institute of Internal Auditors

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