Internal Auditing in the Gulf Cooperation Council Region

Promoting Internal Audit Effectiveness
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About the UAE Internal Auditors Association
The UAE Internal Auditors Association (UAE-IAA) was set up in July 1995 as a non-profit organization and is the official affiliate of Institute of Internal Auditors (IIA) in the United Arab Emirates. Our vision is to be a leading association that promotes innovation and excellence in internal auditing. Our mission is to provide dynamic leadership to advocate and promote the profession of internal auditing throughout the UAE. The UAE-IAA offers regular training programs, workshops, seminars and an annual conference with the objective of promoting the profession within the business community. In addition, we work with regulators to increase awareness of internal audit and internal audit standards. The UAE-IAA has the support of leading companies and professional services firms in the UAE who actively participate in the UAE-IAA’s efforts to promote the profession of internal auditing.

About the Saudi Institute of Internal Auditors
The Saudi Institute of Internal Auditors (IIA-KSA) is a professional institute established under the Council of Ministers Resolution No. (84) dated 28 February 2011. It is a non-profit affiliate of the IIA that is locally under the supervision of the Ministry of Commerce and Industry. IIA-KSA is governed by a Board of Directors whose members are internal audit experts based in Saudi Arabia. IIA-KSA has been a full institute under the IIA since July 2012. The IIA-KSA training team works diligently to research relevant internal audit topics and schedule courses that will add value to its partners and their professional internal auditors.

Project Task Force
Abdulqader Obaid Ali, CFE, CRMA, QIAL
Mohammed A. Alzamil MBA, CFE
Farah Araj, CPA, CIA, CFE, QIAL
Hisham Alhelabi

Authors
Vijesh Ravindran, ACA, CIA, FRM
Farah Araj, CPA, CIA, CFE, QIAL

Reviewers
Hafiz Imtiaz Ahmad, Ph.D.
Hisham Alhelabi

Translation Review Team
Ayman Abdelrahim, MQM, CIA, CCSA, CFE
Qais Hamdan, CISA, CISM, PMP
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As a result of cooperation between the UAE Internal Audit Association (UAE-IAA) and the Saudi Institute of Internal Auditors (IIA-KSA), I am pleased to release this research report on Internal Auditing in the Gulf Cooperation Council (GCC) Region. This report is based on the CBOK 2015 Global Internal Audit Practitioner Survey (Survey) carried out by The Institute of Internal Auditors (IIA) Research Foundation. This is the third research report issued by the UAE-IAA and also the first research report carried out jointly with the IIA-KSA.

This research report would not have been possible without the huge support and contributions of many people. Firstly, I would like to express my thanks to the lead author, Vijesh Ravindran, who analyzed the data, interviewed the experts and delivered this insightful report. Secondly, I would like to thank Farah Araj who proposed the research topic, led the initiative, and brought the whole initiative to life. Also, my appreciation extends to the project task force, the reviewers and translation review team for their excellent contributions.

I also extend my appreciation to each of the 918 internal audit professionals (including 169 chief audit executives) who took time from their busy schedules to anonymously participate in the survey and support the research initiative. Without their participation this research report would not have become a reality. I am also very grateful to the following internal audit leaders who participated in the post survey interviews, shared their experience and gave a real world perspective on the survey's topics:

- Dr. Khalid. Al-Faddagh, Vice Chairman, Audit Oversight Committee at King Fahad University for Petroleum and Minerals
- Asem Al Naser, Chief Audit Executive, Qatar Navigation Q.S.C.
- Gautam Gandhi, Group Risk and Internal Audit Manager, Al Fahim Group
- Andrew Garrett, Partner & Internal Audit Services Leader at PwC Middle East
- Aley Raza, Chief Ethics & Compliance Officer /Director Internal Audit at Emirates National Oil Company Limited (ENOC)
- Thomas Totton, General Manager – Internal Audit, Bank Muscat

Last but not least, this report would not have been published without the support and cooperation of the IIA-KSA. As such, I extend my sincere thanks to Mr. Mohammed Alzamil for his participation and for helping to make this initiative a success.

I am really proud of how the members & supporters of the UAE-IAA and IIA-KSA are supporting our research initiatives. I hope that we can continue to work together to produce regional insights on an annual basis.

AbdulQader Obaid Ali
President
UAE Internal Auditors Association
It gives me a great pleasure to write foreword for this research study conducted by the UAE Internal Auditors Association (UAE-IAA) and the IIA Saudi Arabia for the GCC region. Imagine a world without assurance services to public and private organizations; it would result in an exponential increase in inefficiencies, corruption and mismanagement.

The internal auditing profession has gained significant attention in the GCC region during the last decade. However, the internal auditing functions at many government and private sector organizations are still in the developmental stage.

Given the fact that the world’s business environment is changing rapidly, particularly innovation of new technologies such as automated business-to-business and machine-to-machine transactions, and this increases complexities in the business environment and hence new risks are emerging over the horizon. This poses a great challenge for internal auditors to keep pace with new innovations and skills needed to ensure delivery of effective assurance services to stakeholders and to provide value added recommendations to enhance process efficiency with a better control environment in the best interest of the organization.

Although the survey reveals that the majority of the internal audit functions are reporting to the Board of Directors through the Board Audit Committee or to similar level, but the profession still has not reached to the advance maturity level in the GCC region, therefore, there is a fair need to educate the board members and senior executives on the real definition of Internal Auditing, and its perception as a value addition center rather than a cost center.

Saudi Arabia is the biggest market and has a large number of IIA members in the GCC region, the importance of internal audit services has been well recognized by the Saudi Government, and hence the government has passed a decree to establish internal audit functions at all government departments and the business entities.

The Saudi Capital Market Authority (CMA), which governs the Saudi Stock market (Tadawul), has also put a great emphasis on the system of internal controls at all listed companies, including the existence of an internal audit function.

I applaud all members of the IIA in the GCC region for undertaking and contributing to this valuable research report. I believe that the outcome of this research report will definitely provide a vigorous benchmark against which GCC organizations can assess and monitor improvements in the future. The information included in this research report will be of great value to organizations within the GCC and will help internal audit functions demonstrate the value they can add to government and private organizations.

Mohammed A. Alzamil
Chief Executive Officer
The Institute of Internal Auditors, Saudi Arabia
The world around us has changed and so has the macro-economic landscape, technology, consumer preferences, and the way business is conducted. New risks are emerging, business complexities have increased, economic and political uncertainties are higher than ever. All these, while posing significant challenges, have increased the opportunities for internal audit functions to contribute more to their organizations. However, it is critical for internal audit functions to adapt and change in line with the changes in business & economic environment to remain relevant and effective.

This research report analyses internal audit practices in the Gulf Cooperation Council region (GCC) and explores how internal audit functions can improve their effectiveness to add value to their organizations. This report covers responses from internal auditors working in different sectors across the GCC countries i.e. Saudi Arabia, UAE, Qatar, Kuwait, Oman and Bahrain. A summary of the main findings from our research is as follows:

• **Section 1: Positioning the Internal Audit Function:** The survey results show that a large majority of internal audit functions in the GCC report to the Board or Audit Committee and the number is higher than the Global average. Internal audit functions reporting to the Chief Executive Officer could also be noticed in few cases and this is dominant in public sector (e.g. government agencies) entities and in smaller companies.

• **Section 2: Role of the Internal Audit Function:** Overall the survey results show that assurance activities are the ones that bring most value to the organization. However, the three lines of defense model is defined and understood only in one-third of the organizations surveyed which indicates that the role of internal audit as an assurance provider in the third line of defense may not be well understood in many organizations in the GCC. On a positive note, the survey results show that almost half of the internal audit functions are actively involved in providing advice/consulting for risk management activities with about one third of internal audit functions assuming responsibility for enterprise risk management.

• **Section 3: Internal Audit Focus Areas:** Only in half of the internal audit functions, assurance activities are either fully or mostly aligned to the organisation’s strategic plan. Internal audit functions in the GCC seem to rate operational risks as the top risk while the coverage of assurance of strategic risks appears to be minimal. The Survey results also show inadequate coverage of assurance on risk management effectiveness and organizational governance in the audit plan.

• **Section 4: Processes and Operations:** The majority of internal audit functions update their audit plans one or more times per year but only a small fraction of internal audit functions seem to be adopting flexible audit plans. Similarly, most internal audit functions appear to do annual risk assessments with about one third of the firms doing periodic updates. However, formal Internal Audit Strategic plans are not present in many internal audit functions. Large majority of internal audit functions comply with most of the requirements of the IIA's International Professional Practices Framework (IPPF).
Promoting Internal Audit Effectiveness

- **Section 5: Skills and Resources Management:** Survey results show an increase in requirements for internal audit staffing and skill requirements. However, resourcing of internal audit functions with appropriate skills seems to be a big challenge.

- **Section 6: Leading Practices and Trends:** Organizations and internal audit functions in the GCC seem to have a long way to go when it comes to some of the leading practices expected to be in place in a matured organization. Specifically, this was identified with regard to combined assurance & reporting, auditing sustainability, performance auditing, and auditing ethics and culture. Practices in these areas seem to be in place only in very few organizations.

- **Section 7: Managing Expectations and Demonstrating Performance:** The performance measures used by internal audit functions predominantly focus on operational efficiency and no metrics seems to be in place to measures adequacy of risk coverage and level of assurance provided which is a challenge for the profession.

The results of the research report and analysis provide great insights into the internal audit practices in the GCC. This report will help internal auditors to benchmark their internal audit function to other internal audit functions in the UAE, Saudi Arabia, GCC and globally. We hope the findings and recommendations in this research report will help internal audit functions in the GCC to enhance their practices and improve the image of the internal audit function not only within their organization but also in larger business community.

"In this region understanding of the organization’s culture and the expectations of stakeholders is a critical success factor for internal audit functions"

Dr. Khalid. Al-Faddagh, Vice Chairman, Audit Oversight Committee, King Fahad University for Petroleum and Minerals
Introduction
The existence and the extent of internal audit activities does have an impact on the organization’s value. This has been specifically studied in a research paper which concludes that "In valuing companies without considering the influence of the internal audit and ERM functions, we may be ignoring an important source of risk and/or risk mitigation that materially effect the value".

The objective of internal audit function is to add value to the organization through independent and objective assurance and consulting activities. According to the interpretation to IIA Standard 2000 internal audit function adds value if it provides assurance and contribute to the improvement of efficiency and effectiveness of organization’s governance, risk management, and controls. The effectiveness of the practices followed by the internal audit function drives its ability to achieve their objectives. In this research report we examine the internal audit practices in the GCC region to identify key areas where internal audit functions should focus to improve the effectiveness and contribution of internal audit function to the organization.

Research Approach

The results and analysis in this report are based on responses from the Institute of Internal Auditor’s (IIA) CBOK 2015 Global Internal Audit Practitioner Survey (Survey), the largest survey of internal auditors in the world. The Survey was completed by over 14,000 internal auditors around the world, including over 900 from the Gulf Cooperation Council (GCC) region. Respondents included internal auditors of various ranks belonging to organizations of different sizes from various industry sectors. Details of survey demographics are presented in Appendix 1.

To perform the analysis, we analyzed the Survey based on the overall GCC results, and compared the outcome with the results we obtained from Global respondents in order to arrive at a comprehensive understanding of the internal auditing profession in the GCC. Furthermore, we conducted interviews with internal audit leaders in the GCC to comment on the findings and obtain their insights and recommendations.

Research Objectives

The key objective of the research project was to explore how internal audit functions can be more effective and relevant to add value to the organization, the challenges faced and the changes needed in this regard. Accordingly, this report examines whether:

- Organizational positioning of internal audit functions is appropriate to provide the independence and authority
- Role of internal audit functions is clearly defined and understood
- Internal audit functions are focusing on the critical areas most relevant to the organization
- Internal processes for risk assessment, internal audit planning and compliance with IPPF are appropriate
- Resources and skill requirements are appropriately managed
- Leading practices in internal auditing are adopted
Adequate practices to measure performance of the internal audit function are in place. This report can also be used as a basis for benchmarking internal audit practices in GCC in comparison with Global practices where applicable.

“Expectations from the Internal Audit function are, now, so much more than just traditional assurance. Stakeholders, particularly executive management within the organization, are looking for value added, proactive business insights from the internal audit function as a trusted advisor” - Andrew Garrett, Partner & Internal Audit Services Leader, PwC Middle East

Overview of the Report

The report analyses various domains relevant to the effective performance of internal audit functions under the following sections:

- **Section 1 – Positioning the Internal Audit Functions**: This section analyses the existence of internal audit functions in different types of organizations of varying sizes, organizational position, and governance of internal audit functions.

- **Sections 2 – Role of the Internal Audit Function**: In this section we analyze the role of internal audit functions, other complementary roles that may be undertaken by internal audit functions, potential conflicts, and how to address such conflicts.

- **Section 3 – Internal Audit Focus Areas**: This section reviews the coverage and key focus areas of internal audit activities.

- **Section 4 – Processes and Operations**: This section examines certain critical processes within Internal Auditing such as risk assessment, audit planning, and compliance to IPPF.

- **Section 5 – Skills and Resource Management**: In this section we analyze how internal audit functions manages skill gap.

- **Section 6 – Leading Practices and Trends**: In this section we examine the recent and emerging trends which presents opportunities where internal audit function can add value to their organization.

- **Section 7 - Managing Expectations and Demonstrating Performance**: This section analyses how the performance of internal audit functions is measured and communicated to stakeholders.

The report also provides real world perspectives on some of the survey results as gathered from the post survey interviews in the relevant sections. While this report provides analysis of the survey results and insights, the real value is derived from the opportunities presented in this report for internal audit functions to improve their role, practices, and contributions of internal audit functions in helping organizations to achieve their objectives.
Section 1: Positioning the Internal Audit Function
The positioning of the internal audit function in an organization sets the foundation for its effectiveness. In this section, we discuss the organization and positioning of internal audit functions in the GCC by analyzing the practices relating to the following:

- To whom the internal audit function reports functionally and administratively
- Who decides on the appointment and termination of the CAE
- Who decides on the performance evaluation and rewards of CAE and internal audit staff

### Functional and Administrative Reporting Lines

77% of respondent CAEs indicated that their internal audit function reports to board or audit committee which is marginally higher than the Global average of 72%. Interestingly, in the case of 33% of CAEs in private companies in the GCC, the functional reporting line is directly to the board which is significantly higher than overall average of 14% that report directly to the board Globally. This may be an indication of less formal governance structures in private companies without audit committees as a result of which the CAE reports directly to the board.

In a minority of cases, the functional reporting line for internal audit function seems to be to Chief Executive Officer (18% of CAEs). This appears to be more dominant in the public sector (including government agencies and government-owned operations) and in smaller companies with revenues below USD 1 Million. While the functional reporting line to the CEO may not seem appropriate, considering the fact that these entities may not have the same governance structure (i.e. no board of directors, etc) as a listed company, the reporting line to CEO may be arguably justified.

#### 1.1 Functional & administrative reporting line of the chief audit executive
In terms of administrative reporting, 64% of internal audit functions in the GCC report to the CEO while in 27% cases administrative reporting is to the whole board. When compared to global results, the administrative reporting line for internal audit functions in the GCC seems to be following much better practices as 64% of CAEs report to the CEO which is higher than the 49% globally.

**Appointment and Evaluation of the Chief Audit Executive**

The authority which appoints and evaluates the performance of the CAE has a significant impact on the independence and authority of the internal audit function. In 72% cases, the final decision on appointment of CAEs is taken by the Board/Audit Committee or its Chairperson. We also see that in 25% of the cases in the GCC, the CEO appoints the CAE. This is similar to the global average.

### 1.2 Who appoints the chief audit executive

The authority deciding on the performance of CAE is marginally different from the results of who decides on the appointment of the CAE. Decisions on the appointment of the CAE are taken by Board/Audit Committee in 63% cases (while 77% functionally report to the board or audit committee). Perhaps this is one area where internal audit practices in the GCC require some consideration as CEO or executive management’s influence on the performance evaluation and rewarding of CAE will have an impact on internal audit function’s positioning regardless of the formal functional reporting line.

### 1.3 Who decides on the performance evaluation of the chief audit executive

Overall, internal audit functions in the GCC seem to be in line with best practices when it comes to functional and administrative reporting. One take away for CAEs and governance bodies is to review the authority for evaluating the performance of the CAE where such authority vests with CEO or executive management.
Section 2: Role of the Internal Audit Function
This section examines the role of internal audit within the three lines of defense model, analyses the level of assurance activities vs consulting activities, and examines the internal audit function’s role in an organization’s risk management processes.

**The Three Lines of Defense**

One of the challenges for internal audit functions is the potential lack of clarity of expectations & ambiguity in roles specifically with regard to second line of defense responsibilities such as compliance, risk management, and quality assurance. Specifically, stakeholders including the Board/Audit Committee and executive management may not understand the role of the internal audit function as an overall assurance provider or other related roles with regard to governance, risk management and controls.

**2.1 Implementation of the Three Lines of Defense Model**

Analysis of the survey results in this regard shows that the Three Lines of Defense Model is clearly defined and understood in 44% of cases in the GCC while it is not followed in 25% of cases. In about 11% cases the roles are not clear and in other 10% cases IA function is the second line of defense.

Regional analysis indicates that UAE practices are more in line with Global averages wherein distinct majority of internal audit function are recognized as a third line of defense function.

The Three Lines of Defense should be formally defined and understood and that internal audit functions should not be held primarily responsible for risk management or risk occurrences. One could argue that, this also puts the internal audit function in the back seat and decreasing its relevance. In other words, the perception is that being in the last line of defense puts internal audit away from the business hotspot and hence it could lose importance.
Ultimately, the need and relevance of Three Lines of Defense would depend on the maturity of the organization. The expectations of the ultimate stakeholders should drive the role of internal audit and the need for formalizing the Three Lines of Defense. In private companies where the owners are usually part of executive management or the board, internal audit may be expected to take on second line of defense functions. In such cases CAEs have the responsibility to educate the stakeholders and improve the organization’s maturity upon which the Three Lines of Defense Model may be implemented in the long run. Where the organization is mature, then the role of internal audit is much clear and the CAE’s job becomes much easier. Many experts in the field of internal auditing support this view.

“While the three lines of defense model places IA as the third line of defense, in my practical experience in the region, internal audit could possibly be looked upon as second or even first line of defense against occurrence of risk events particularly operational risks” - Gautam Gandhi, Group Risk and Internal Audit Manager, Al Fahim Group

“In smaller set ups, audit may also take on the second line of defense function such as compliance in its various forms, however, as the organization expands and mature, it can be spin off as a separate function. This would be the natural evolution” - Dr. Khalid Al-Faddagh, Vice Chairman, Audit Oversight Committee, King Fahad University for Petroleum and Minerals

Assurance vs Consulting Activities

Providing assurance on the adequacy and effectiveness of the internal control system was selected as the top area where internal audit adds value to the organization. Other activities rated among the top five activities, include recommending business improvement, providing assurance on organization’s risk management process, assurance on organization’s governance process, and assurance on regulatory compliance. Overall the survey results show that assurance activities are the ones that bring the most value to the organization through which internal audit function should contribute to the overall improvement of the business through their recommendations.

2.2 In your opinion, which are the five internal audit activities that bring the most value to your organization

<table>
<thead>
<tr>
<th>Description</th>
<th>GCC</th>
<th>UAE</th>
<th>KSA</th>
<th>Global</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assuring the adequacy and effectiveness of the internal control system</td>
<td>85%</td>
<td>84%</td>
<td>87%</td>
<td>86%</td>
</tr>
<tr>
<td>Recommending business improvement</td>
<td>62%</td>
<td>65%</td>
<td>56%</td>
<td>55%</td>
</tr>
<tr>
<td>Assuring the organization’s risk management processes</td>
<td>52%</td>
<td>47%</td>
<td>62%</td>
<td>53%</td>
</tr>
<tr>
<td>Assuring the organization’s governance processes</td>
<td>50%</td>
<td>47%</td>
<td>54%</td>
<td>37%</td>
</tr>
<tr>
<td>Assuring regulatory compliance</td>
<td>41%</td>
<td>31%</td>
<td>54%</td>
<td>50%</td>
</tr>
<tr>
<td>Informing and advising management</td>
<td>29%</td>
<td>38%</td>
<td>28%</td>
<td>40%</td>
</tr>
</tbody>
</table>
Similarly, 80% of internal audit functions in the GCC either focus fully or predominantly on assurance activities with 15% spending an equal amount of time between assurance and consulting activities. Further analysis indicates that internal audit functions in the financial sector spent more resources on consulting activities wherein in 30% of cases internal audit resources are spent either equally on consulting and assurance or more on consulting. Similar analysis also indicates that internal audit functions in organizations with more than 10 billion US Dollars in annual revenues also spend resources on consulting and equally on assurance.

Regional analysis shows consistency in results as a significant majority of the internal audit functions spend most of their resources on assurance activities with only some resources spent on consulting activities.

2.3 How are internal audit resources divided between assurance and consulting?

In pursuit of adding value internal audit functions may assume responsibilities that could potentially conflict with their independence and objectivity. Therefore, internal audit functions are better off allocating a significant portion of their resources on assurance activities than on consulting activities. However, specific organizational priorities, and stakeholders’ expectations may require internal audit functions to focus more on consulting activities. This could be the case in private organizations. An approach with more focus on consulting work may be justified provided it is specifically requested from the ultimate stakeholders (including shareholders). Adequate care needs to be taken in such cases including clearly communicating any potential conflicts/independence issues that may arise including their impact while avoiding decision making/implementation responsibilities.

“It is important to balance independence versus demonstrate value added consulting engagements. Number one priority is the independence of the internal audit function as it is very critical. Consulting activities should not be at the cost of assurance. The internal audit function can provide consulting services in areas where assurance is already provided. However, we should not forget the fact that there is a built in consultation in every assurance assignment provided that internal audit does not get involved in decision making” - Dr. Khalid Al-Faddagh, Vice Chairman, Audit Oversight Committee, King Fahad University for Petroleum and Minerals
The Role in Risk Management

Risk management practices in the GCC appear to be in their early stages. About 18% of the CAEs surveyed indicated that their organization does not have a formal risk management process while 50% CAEs responded that risk management processes are informal and just developing. Internal audit functions in these organizations have the responsibility to promote the understanding and importance of a structured approach to managing risk and should facilitate the implementation of a formalized risk management process.

2.4 Risk Management Practices in place

One of the primary responsibilities of an internal audit function is to provide assurance on how an organization’s risks are being managed (Table 2.5 below). This includes how individual risks are managed as well as the approach, process and systems in place to identify, assess and manage organization wide risks. In addition to assurance, internal audit functions are also involved in advising and performing consulting activities to promote, and facilitate implement risk management.

2.5 What areas of responsibility does internal audit have related to risk at your organization?

<table>
<thead>
<tr>
<th>Description</th>
<th>GCC</th>
</tr>
</thead>
<tbody>
<tr>
<td>Provide assurance on risk management as a whole</td>
<td>47.38%</td>
</tr>
<tr>
<td>Provide advice and consulting on risk management activities</td>
<td>45.93%</td>
</tr>
<tr>
<td>Provide assurance on individual risks</td>
<td>36.48%</td>
</tr>
<tr>
<td>My organization doesn’t follow a risk-based approach</td>
<td>12.50%</td>
</tr>
<tr>
<td>Other</td>
<td>5.96%</td>
</tr>
</tbody>
</table>

Interestingly, in 30% cases (Table 2.6 below), internal audit functions in the GCC are responsible for enterprise risk management. Such an arrangement could be carried out with appropriate safeguards by internal audit as it is better than not having any risk management efforts. In such situations, it is essential for CAEs to communicate and obtain the buy in from the relevant stakeholders, and to avoid decision
making responsibilities. In the longer term, it is essential that Risk Management is positioned as second line of defense function and Internal Audit as third line of defense while coordinating their activities to optimize the overall development and improvement of risk management activities. In a large majority of the organizations in the GCC (61%) this appears to be in place except for few organizations (9%) where the Risk Management and internal audit do not interact.

2.6 What is the relationship between internal audit and enterprise risk management?

<table>
<thead>
<tr>
<th>Description</th>
<th>GCC</th>
</tr>
</thead>
<tbody>
<tr>
<td>Internal audit and ERM are separate functions, and they do not interact.</td>
<td>8.90%</td>
</tr>
<tr>
<td>Internal audit and ERM are separate functions, but they coordinate and share knowledge.</td>
<td>60.98%</td>
</tr>
<tr>
<td>Internal audit is responsible for the current ERM function, but responsibility will be transferred to another department</td>
<td>14.77%</td>
</tr>
<tr>
<td>Internal audit is responsible for the organization’s ERM function.</td>
<td>15.34%</td>
</tr>
</tbody>
</table>

“If the organization does not have a formal ERM program, internal audit should perform risk assessment by involving the management. The outcome of the risk assessment exercise should eventually be transferred to the business. The internal audit function is in the best position to initiate and facilitate the early stages of the ERM. The Internal audit department will continue to update and maintain their own risk registers until the company is mature enough to establish a comprehensive ERM program” - Asem Al Naser, Chief Audit Executive, Qatar Navigation Q.S.C.
Section 3: Internal Audit Focus Areas
The scope of internal audit activities has evolved over the years. Traditionally the focus of the internal audit function was around financial controls, later it extended to cover operational processes. In the last decade the focus became much broader covering organization governance and risk management with recent emphasis on strategic risks. This will continue to evolve and it is critical for internal audit functions to keep up with the changes in order to be successful. This section reviews the opportunities for improvement in internal audit processes by specifically analyzing coverage and key focus areas of internal audit activities.

Top Risks and Areas of Focus

Internal audit functions in the GCC seems to focus mainly on operational risks where 81% of CAEs indicated operational risk as the top risk item followed by cost reduction/containment, information technology risks, and risk management effectiveness. The results show that risk management and organizational governance are not high on the internal audit or executive management agenda. Further, there is a large expectations gap between the views of executive management and CAEs as it relates to cost reduction and information technology. Internal audit seems to place more importance on these areas that executive management.

3.1 The top five risks on which are receiving the greatest level of attention in the GCC

<table>
<thead>
<tr>
<th>Description</th>
<th>Executive Management</th>
<th>CAEs</th>
<th>Expectations Gap</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost/expense reduction or containment</td>
<td>45%</td>
<td>69%</td>
<td>-24%</td>
</tr>
<tr>
<td>Information technology (IT), not covered in other audits</td>
<td>39%</td>
<td>59%</td>
<td>-20%</td>
</tr>
<tr>
<td>Risk management assurance</td>
<td>49%</td>
<td>31%</td>
<td>18%</td>
</tr>
<tr>
<td>Strategic business risks</td>
<td>70%</td>
<td>53%</td>
<td>17%</td>
</tr>
<tr>
<td>Governance</td>
<td>52%</td>
<td>35%</td>
<td>17%</td>
</tr>
<tr>
<td>Operational</td>
<td>76%</td>
<td>81%</td>
<td>-5%</td>
</tr>
<tr>
<td>Compliance/regulatory</td>
<td>48%</td>
<td>49%</td>
<td>-1%</td>
</tr>
</tbody>
</table>

Analysis of internal audit plans in the GCC also show similar results. Operational risks comprise, on an average, 28% of the internal audit plan. Coverage of risk management effectiveness and organizational governance seems to be limited. This could be due to lower attention/importance on overall governance but could also be due to fact that very limited resources are spent on such areas as risk management effectiveness and governance reviews are at high level.
3.2 Coverage of top risks in 2015 audit plan (as a % of the audit plan)

<table>
<thead>
<tr>
<th>Description</th>
<th>Average %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operational</td>
<td>28%</td>
</tr>
<tr>
<td>Strategic business risks</td>
<td>14%</td>
</tr>
<tr>
<td>Risk management assurance/effectiveness</td>
<td>11%</td>
</tr>
<tr>
<td>Information technology (IT), not covered in other audits</td>
<td>9%</td>
</tr>
<tr>
<td>Compliance/regulatory</td>
<td>8%</td>
</tr>
<tr>
<td>Corporate governance</td>
<td>7%</td>
</tr>
</tbody>
</table>

Aligning to Business Strategy and Focus on Strategic Risks

Only 55% of the internal audit functions in the GCC are either fully or mostly aligned to strategic plans of the organization. Besides only 53% of survey respondents indicated strategic risks as the top risk that receives the greatest level of attention in 2015. The extent of internal audit focus (53%) is way below executive management’s expectations on assurance of strategic risks (70%). However, assurance of strategic risks is receiving increasing attention as could be noted from the fact that 71% of the CAEs surveyed indicating that audit focus is expected to increase on strategic business risks.

<table>
<thead>
<tr>
<th>Description</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fully aligned</td>
<td>14%</td>
</tr>
<tr>
<td>Almost fully aligned</td>
<td>41%</td>
</tr>
<tr>
<td>Somewhat aligned</td>
<td>35%</td>
</tr>
<tr>
<td>Minimally aligned/not aligned</td>
<td>9%</td>
</tr>
</tbody>
</table>
Internal audit functions should align their activities to organization's objectives and plans and should increase focus on the strategic business risks which impacts the achievement of business strategy, future plans, growth and shareholder value.

It is important for the CAE to understand the strategic plans and priorities of the organization to align the internal audit activities according to the needs of the organization. This could be through participation in the strategic planning process. Although one of the challenges is that CAE may not be involved in the strategic planning process, it should not be a deterrent to understanding and aligning to the organization's strategic objectives.

**Assurance on Governance**

Predominantly review of governance is limited to review of policies and procedures in general. Due diligence audits for acquisition and/or divestiture is the least area where internal audit is involved in as part of its contribution to improving overall organization's governance. The results indicate that there are several gaps in areas covered as part of governance reviews that presents opportunity for internal audit functions to contribute towards organization's governance. Carrying out entity wide ethics related audits and executive compensation assessments are some of the avenues that internal audit functions should include in their annual plan.

### 3.3 Internal Audit Activities Related to Governance Reviews in the GCC

<table>
<thead>
<tr>
<th>Description</th>
<th>None</th>
<th>Minimal</th>
<th>Moderate</th>
<th>Extensive</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reviews of governance policies and procedures in general</td>
<td>10%</td>
<td>18%</td>
<td>36%</td>
<td>36%</td>
</tr>
<tr>
<td>Reviews of governance policies and procedures related to the organization's use of information technology (IT) in particular</td>
<td>14%</td>
<td>15%</td>
<td>50%</td>
<td>20%</td>
</tr>
<tr>
<td>Due diligence audits for acquisition and/or divestiture</td>
<td>40%</td>
<td>27%</td>
<td>27%</td>
<td>7%</td>
</tr>
<tr>
<td>Audits of the internal operations of external providers of major services</td>
<td>27%</td>
<td>23%</td>
<td>35%</td>
<td>15%</td>
</tr>
<tr>
<td>Reviews addressing linkage of strategy and performance</td>
<td>19%</td>
<td>25%</td>
<td>35%</td>
<td>21%</td>
</tr>
<tr>
<td>Executive compensation assessments</td>
<td>43%</td>
<td>27%</td>
<td>26%</td>
<td>5%</td>
</tr>
</tbody>
</table>
The survey result also indicates lack of board support as one of the potential challenges to perform a comprehensive review of organizational governance. Only 53% of the CAEs surveyed indicate that they get complete support from the board of directors.

### 3.4 Support internal audit receives from the board of directors (or equivalent) to review the organization’s governance policies and procedures

The chart below illustrates the support received from the board of directors across different regions:

- **Other GCC**: 45% Complete support, 30% Some support, 25% No support
- **KSA**: 50% Complete support, 40% Some support, 10% No support
- **UAE**: 55% Complete support, 40% Some support, 5% No support
- **Global**: 52% Complete support, 40% Some support, 8% No support
- **GCC**: 50% Complete support, 45% Some support, 5% No support

Internal Audit functions in the UAE are getting more support from Board for governance reviews than in other GCC countries and is even better than Global averages.

One way to gain the support of Board is by demonstrating how effective governance can increase the value of the organizations.

“For regulated entities gaining Board support for governance is relatively easy. The effect of sound governance framework reflects in the company’s performance, share price and shareholder value. In private companies the aim should be to make the company more attractive to external stakeholders, this could be customers in new markets or a potential external investor. Value creation objectives could be measured from an initial public offering or trade sale point of view whether or not such shareholders have such intent” – Thomas Totton, General Manager – Internal Audit, Bank Muscat

### Regulatory Risks

Compliance with regulatory risks ranks fourth in the view of executive management while it only ranks sixth in term of importance it receives from the internal audit function. Further the coverage of regulatory risks is minimal in the assurance plans as could be noted from the survey and large majority of the survey respondents feels that current level of attention on regulatory risks will not change. However regulatory risks are becoming increasingly important and cannot be ignored. Regulatory changes have the potential for driving and changing the business model of organizations.

“Risks from changes in regulations and new regulations is becoming more and more important in this region. One of the biggest challenges in this region is to keep abreast of upcoming changes. Some of the regulatory changes, for instance, environmental regulations, tax, could have significant impact of the business strategy and operating model. While this may have negative impact in terms of cost of compliance it could also present some opportunities” – Gautam Gandhi, Group Risk and Internal Audit Manager, Al Fahim Group
Section 4: Processes and Operations
This section reviews opportunities for improvement in internal audit processes by specifically analyzing audit planning, mechanism for reporting, and resolving organizational issues, and quality assurance.

**Managing Changes and Uncertainties Through Flexible Planning**

In recent days organizations are going through several changes and uncertainties. For instance, technological changes have put some reputed companies out of business. Similarly, regulatory changes could have significant impact on business. Various systemic risk events are occurring and quite frequently which is impacting the economies across the globe. Events of terrorism, act of nature, and political crisis also do impact economy and have the potential to spread across different regions. It has therefore become important to keep an eye on the changing economic, political, regulatory, and business environment in order to identify and consider emerging risks as part of the internal audit plan.

### 4.1 Development of the audit plan at your organization

![Graph showing audit plan development frequency in GCC, Global, UAE, and KSA]

- **GCC**: 49% Developed each year and updated three or more times per year as risks change
- **Global**: 44% Developed each year and updated one or two times per year
- **UAE**: 22% Developed each year and not changed during the year
- **KSA**: 18% Highly flexible plan matched to the organization’s changing risk profile

**From Hindsight to Insight and Foresight**

There is a general perception that internal audit functions largely report/highlight historical or out date issues. Therefore, it is important for internal audit functions to be proactive, to reduce time lag in reporting. Periodic review of risk assessment and flexible approach to audit planning would go a long way in enabling the internal audit functions to focus and highlight current and emerging issues. Such an approach to risk assessment and internal audit planning should be complemented by techniques such as continuous auditing, and data analytics to provide assurance of key risks/controls on an ongoing basis and to identify red flags and exceptions as and when they occur.

“Internal Auditing should be more proactive. The focus should be on foresight, insight and even oversight rather than hindsight. Post fact audit and too much lag in reporting issues contributes to the police tag” - Aley Raza, Chief Ethics & Compliance Officer/Director Internal Audit, ENOC

The risk assessment and audit plan should be reviewed frequently so that changing risk profile of the organization is captured appropriately and to ensure that such changes are appropriately reflected in the internal audit activities. Internal audit functions who do not perform annual or more frequent risk assessments are in danger of becoming outdated and irrelevant. While continuous risk assessment may not be practical for all organization, annual risk assessment with periodical update would work well for many other organizations.
It is not practical for all internal audit functions to carry out comprehensive risk assessment every year considering resource and time requirements. On the contrary focused risk assessment may not be fully appropriate as it may not cover various operational risks which could still be important for the business and stakeholders. Internal audit functions may follow a hybrid model where comprehensive risk assessment may be done once in three years complemented by focused risk assessment done annually with periodical updates.

**Catalyst for Change – Resolving Issues**

Another area where internal audit functions can make a difference is through actively being involved in addressing the organizational risks and issues. Internal Auditor’s responsibility does not stop with identifying an issue/potential risk and reporting it with recommendation. The real value occurs when management acknowledges the issues and the recommendations actually gets implemented. Internal audit functions that go the extra mile to ensure critical changes are done will build the right image. Internal audit functions should be known for positive changes that were implemented and realized within the organization.

Survey results indicate that in around 70% of internal audit functions in the GCC are responsible for implementing the audit recommendations either solely or jointly with the process owner.

4.2 **If an audit report has findings that need corrective action, who has the primary responsibility to monitor that corrective action has been taken?**

<table>
<thead>
<tr>
<th>Description</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>The audited entity/process owner</td>
<td>26.00%</td>
</tr>
<tr>
<td>The internal audit department</td>
<td>27.03%</td>
</tr>
<tr>
<td>Both internal audit and the audited entity/process owner</td>
<td>43.57%</td>
</tr>
<tr>
<td>Not applicable (There is no formal follow up.)</td>
<td>3.40%</td>
</tr>
</tbody>
</table>

"Timely resolution of audit issues is very critical and should be jointly owned by the business and internal audit. CAE should push for non-resolved issues. This should also be a KPI for Internal Audit function" – Aley Raza, Chief Ethics & Compliance Officer/Director Internal Audit, ENOC
Policies and Documents

Large majority of the respondents indicated that Internal Audit Charter, mission statement, code of conduct/ethics, and internal audit operating manual in their organizations (79%, 62%, 63% and 70% respectively). Only 43% of the survey respondents indicated that the internal audit function in their organisation has an Internal Audit Strategy. This is in line with the fact that only 54% of the internal audit functions seem to align its activities to organisation’s strategy.

4.3 Which of the following internal audit policies or documents exist in your organization?

The Internal Audit Strategy description is as important as the strategy for the organization as whole. It should spell out how the internal audit function plans to achieve its overall mission and vision and specify the approach of internal audit functions as to align their internal audit activities to the business strategy. It should not be limited to assurance and consulting activities, rather it should identify the strategic risks that would negatively impact the achievement of business strategy, how internal audit function plans to assess and provide assurance on such risks, resource requirements, and how such requirements are addressed.

Quality Assurance and Conformance to IIA Standards

Compliance with the Internal Audit Standards not only demonstrates the credibility of the processes followed but also determines the effectiveness of the internal audit function. The results on compliance to IIA Standards is a bit disappointing as only 57% of the survey respondents confirmed that their organization use all of the IIA Standards. This number increases to 64% in the UAE.

4.4 Use of the International Standards for the Professional Practice of Internal Auditing (Standards)
The top reasons noted for not complying with IIA Standards seems to be lack of staff and lack of support from management. Further analysis indicate that least amount of compliance was noted with regard to Standard 1300 – Quality Assurance and Improvement Program and Standard 2600 - Communicating the Acceptance of Risks.

4.5 Reasons for not conforming with all of the Standards

- Too time-consuming
- Superseded by local/government regulations or standards
- Not appropriate for small organizations
- Lack of perceived benefit compared to cost
- Inadequate internal audit staff
- Compliance not supported by management/board

“CAE should take the responsibility for compliance to IIA Standards. Where non compliances are due to lack of support from Board/Management, could be risk culture issue. It is the responsibility of the CAE to educate the Board/AC/Executive management and to initiate efforts to promote the right risk culture” - Aley Raza, Chief Ethics & Compliance Officer/Director Internal Audit, ENOC
Section 5: Skills and Resources Management
It is important that the internal audit function is staffed with the right skills to understand the business, and various risks facing it. Internal audit also needs to have business acumen, people management and other soft skills. Meeting the skill and resource requirements are challenging due to non-availability of skills, budget constraints etc.

"Acquiring talent and developing business acumen skills are some of the biggest challenges facing the profession of Internal Auditing" - Andrew Garrett, Partner & Internal Audit Services Leader, PwC Middle East

**Skills Needed & Resourcing Expectations**

The skills that are sought after the most seems to be accounting, analytical/critical thinking, communication, industry specific knowledge, IT and business acumen. While accounting skills are the traditional requirement, the need for analytical thinking and business acumen demonstrates the changing landscape of internal audit skills which reflects growing expectations from stakeholders and the changing focus of internal audit functions.

5.1 Top skills recruited the most in internal audit departments in the GCC

<table>
<thead>
<tr>
<th>Skill</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Information technology (general)</td>
<td>40%</td>
</tr>
<tr>
<td>Industry-specific knowledge</td>
<td>35%</td>
</tr>
<tr>
<td>Communication skills</td>
<td>30%</td>
</tr>
<tr>
<td>Analytical/critical thinking</td>
<td>25%</td>
</tr>
<tr>
<td>Accounting</td>
<td>20%</td>
</tr>
</tbody>
</table>

Further, the survey results show an increase in the required amount of internal audit staff and an expected increase in internal audit budgets.

"More resources do not necessarily mean more assurance. It’s important for the CAE to have clear understanding and agreement by the Board and Executive Management on the level of assurance expected, and accordingly, the resource requirements should to be determined" - Asem Al Naser, Chief Audit Executive, Qatar Navigation Q.S.C.

**Professional Certification**

One way to ensure that internal audit staff possess the relevant internal audit skills is to ensure that they have the relevant professional certifications and/or qualifications related to internal auditing. The survey results indicate that around 54% of staff in internal audit functions in the GCC do not possess any certification/qualification in internal auditing. This is the case with even those who occupy senior positions including CAEs whereby 40% do not have a professional certification/qualification in internal auditing (Table 5.2 below). However many practitioners seem to have other related qualifications such as public accounting (CA/CPA) either in lieu of or in addition to their internal auditing qualification.
5.2 Professional certifications and/or qualifications related to internal auditing:

<table>
<thead>
<tr>
<th>Professional Certifications/Qualification</th>
<th>Chief Audit Executive</th>
</tr>
</thead>
<tbody>
<tr>
<td>CIA (Certified Internal Auditor)</td>
<td>39%</td>
</tr>
<tr>
<td>CCSA (Certification in Control Self-Assessment)</td>
<td>8%</td>
</tr>
<tr>
<td>CRMA (Certification in Risk Management Assurance)</td>
<td>15%</td>
</tr>
<tr>
<td>QIAL (Qualification in Internal Audit Leadership)</td>
<td>4%</td>
</tr>
<tr>
<td>No Professional Certification or Qualification</td>
<td>40%</td>
</tr>
</tbody>
</table>

**Staff Rotation**

One way to address the skill gaps and to ensure internal audit staff understands and gains the requisite business skills is through staff rotation. This implies deploying internal audit staff to handle operational/management responsibilities and using business people for internal audit activities. One such popular concept is the guest auditor, where depending on the nature of the assignment, the internal audit function can use experts within the business to audit a specific technical area.

Very few organizations in the GCC seem to have adopted the concept of staff rotation and there lies a big opportunity for internal audit functions.

5.3 Does your organization have a process in place to rotate staff through the internal audit department as part of training them for management in other parts of the organization?

<table>
<thead>
<tr>
<th>Description</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>No</td>
<td>56%</td>
</tr>
<tr>
<td>Yes, an informal process</td>
<td>30%</td>
</tr>
<tr>
<td>Yes, a formal process</td>
<td>14%</td>
</tr>
</tbody>
</table>

It is strongly recommended to use guest auditors and rotate internal audit staff to handle business responsibility.

"CAE's should consider bringing on board technical experts when conducting complex audits to create an integrated team, consisting of audit staff and external experts to create the right combination of subject matter experts and in-house knowledge. The external experts could be from within the organization as well. There is the need to open the door for exchange programs through technical rotational assignment where audit staff and staff handling business roles can mutually benefit.

On motivating staff from other business units to join the audit team, access to learn and the exposure to different segments of the business would be a great selling point. I’m yet to see a bad review from any of the guest auditors we had on rotational assignments. The positive word goes around creating favorable reputation for the internal audit function” - Dr. Khalid. Al-Faddagh, Vice Chairman, Audit Oversight Committee, King Fahad University for Petroleum and Minerals
Outsourcing

One way to meet the lack of skills/resources within internal audit is to source from professional service providers. This could be through full outsourcing or co-sourcing or using professional services firms for carrying out specific tasks where the internal audit function needs support. Around 44% of internal audit functions in the GCC have used the services of professional service providers of which around 40% (overall 20%) seems to use third party service providers to cover more than 40% of their internal audit activities. Around 49% of the CAEs expect that the budget for use of third party service providers will increase.

| Percentage of Internal Audit Activities Performed by Third Party Service Providers |
|---------------------------------|---|
| less than 10%                  | 15% |
| 10% to 24%                     | 33% |
| 25% to 49%                     | 12% |
| 50% to 74%                     | 18% |
| 75% to 100%                    | 22% |

“One way to address the issue of skills is to source subject matter experts from professional services firms. CAEs can also source specialists internally from the relevant business unit within the organization, who is independent of the engagement, to be used as subject matter expert.

In some of the leading global firms, the Internal Audit function is used as a training ground for high fliers. Similarly rotating Internal Audit staff across the business units through internal staff loaning arrangements is something CAEs should try to do.

Due to rapid developments in new and emerging risk areas such as Cyber Security and Data privacy, Social Media, Big Data, and Sustainability, CAEs are finding it more and more difficult to acquire the relevant skill sets to address these risks. CAEs should consider the use of professional services firms to source relevant skills in this space. Professional services firms, particularly the ones with Global presence, with their vast resources and research initiatives can bring leading edge international expertise to benefit clients in the Middle East.

- Andrew Garrett, Partner & Internal Audit Services Leader, PwC Middle East
Section 6: Leading Practices and Trends
In this section we examine some of the leading practices in internal audits and analyze to what extent internal audit functions in GCC have adopted such practices.

**Combined Assurance**

According to the Three Lines of Defense Model, the internal audit function acts as the third line of defense by providing assurance on entity wide risks and risk management. There are other assurance providers, such as risk management, compliance, quality assurance, and health/safety/environment functions who proactively involve in actively managing the risks, as the second line of defense. It is very critical that the activities of the internal audit function and other assurance providers are coordinated to optimize the organization wide assurance activities to add the best value to the organization.

A combined assurance model is a formal approach to understanding of roles of internal audit and other assurance providers with regards to managing risks across the organizations. It also involves formal combined reporting on the organization wide risks and risk management jointly by the internal audit function and the other relevant assurance providers as second line of defense.

The survey indicates that only a few organizations in the GCC have implemented a combined assurance model. Only 33% of the organizations have already implemented or are in the process of implementing the combined assurance model and only half of such organizations have formal combined assurance reporting in place. However, 39% of the organizations expect to adopt combined assurance model in the next 2 to 3 years.

The survey results clearly show that combined assurance and reporting is still an emerging concept in the GCC.

6.1 Has your organization implemented a formal combined assurance model?

<table>
<thead>
<tr>
<th>Implementation of Formal Combined Assurance Model</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>No, but plan to adopt one in the next 2 to 3 years</td>
<td>39%</td>
</tr>
<tr>
<td>No, and do not have plans to adopt one in the next 2 to 3 years</td>
<td>28%</td>
</tr>
<tr>
<td>Yes, implemented now</td>
<td>24%</td>
</tr>
<tr>
<td>Yes, but not yet approved by the board or audit committee</td>
<td>9%</td>
</tr>
</tbody>
</table>

“CAE’s can help the organization adopt a Combined Assurance model. Through assurance mapping and combined assurance reports CAEs can help the stakeholders to get a picture of overall assurance across the organization gained from various assurance providers” - Andrew Garrett, Partner & Internal Audit Services Leader, PwC Middle East

**Sustainability Auditing**

Environmental sustainability is gaining more and more importance across the world. Organizations are under increasing pressure to remain accountable for the environmental impact caused from their operations. Sustainability reporting is one part of many initiatives in this direction. The regulatory requirements are increasing in this area and the GCC is not an exception to this. Sustainability reporting requires an organization to be transparent by disclosing information about the economic, social, and
environmental impact of its activities and the efforts it has taken to minimize negative impact and risks.

The survey results indicate that sustainability reporting is not widely practiced in many organizations. Overall only 24% of the firms seem to have adopted formal sustainability reporting and as would one expect such a practice was found to be in place mostly in publicly traded companies. Analysis also shows that companies in energy, utilities and educational services sectors also seem to issue sustainability reports. This is quite understandable as organizations in these sectors are expected to have more environmental impact and related regulations to protect environment and promote sustainability.

6.2 Does your organization plan to release a report on sustainability?

<table>
<thead>
<tr>
<th>Description</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes, this year</td>
<td>24%</td>
</tr>
<tr>
<td>Yes, at some point in the next 2 to 3 years</td>
<td>16%</td>
</tr>
<tr>
<td>Yes, at an unspecified point in the future</td>
<td>16%</td>
</tr>
<tr>
<td>No</td>
<td>43%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Description</th>
<th>None</th>
<th>Minimal</th>
<th>Moderate</th>
<th>Extensive</th>
</tr>
</thead>
<tbody>
<tr>
<td>Environmental sustainability audits</td>
<td>54%</td>
<td>25%</td>
<td>16%</td>
<td>5%</td>
</tr>
</tbody>
</table>

“Sustainability is going to be very important for all organizations which need to assess its direct and indirect impact on environment over the short and long term. The level of awareness in this space seems to be relative to the nature of the organization. For instance, initiatives on how to address sustainability issues are expected to be in place oil & gas and banking sectors. However, it is important for all organizations to start looking at this area and this should be an area of focus for CAEs” – Thomas Totton, General Manager – Internal Audit, Bank Muscat

“Corporate Sustainability is beginning to receive attention in this region. For instance auditing Corporate Sustainability is firmly on the agenda of subsidiaries of Global corporations. Another example is the growing importance being placed by the Governments in the region on Workers Welfare, which is leading to voluntary third party monitoring and disclosure by some entities.

Sustainability reporting is not limited to environmental issues. It extends to assessing the fundamentals of a business’ model and strategy, supporting it in achieving its’ vision for the future. Internal Audit function has an important role in assessing how the organization manages sustainability issues and therefore CAEs in the region should start focusing on this area” - Andrew Garrett, Partner & Internal Audit Services Leader, PwC Middle East
Auditing Ethics and Culture

Organization culture implies the attitude and perception within the organization with regard to governance, risk management, control, performance, integrity and ethics. Successful organization always demonstrate strong culture of governance. Traditionally organization culture has not been an area of focus mainly because it is subjective and there are not many accepted methodologies/standards with regard to auditing culture. Auditing entity level audit of ethics is another area which is not widely in practice due to similar reasons. The limited practices with regard to ethics related audits is clearly reflected in survey results as only 17% of internal audit functions seems to carry out ethics related audit.

6.3 What is the extent of activity for your internal audit department related to ethics related audits

<table>
<thead>
<tr>
<th>Description</th>
<th>None</th>
<th>Minimal</th>
<th>Moderate</th>
<th>Extensive</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ethics-related audits</td>
<td>27%</td>
<td>29%</td>
<td>27%</td>
<td>17%</td>
</tr>
</tbody>
</table>

One of the possible challenges to auditing ethics and corporate code of conduct requirements is limited information with regard to the employees’ personal activities and information. Specifically auditing ethics may involve access to employees’ property and records. However the survey results shows this is not the case of internal audit functions in the GCC where around 80% of the survey respondents indicated that they have access to employees’ property and records most of the time or all the time.

“Ethical issues should be considered and covered in every audit and issues identified need to be reported for resolution. This is an essential part of the role of internal audit function as is covered by IPPF. An Organization wide ethics management audit should be conducted and while it also depends on the maturity of the CAE and the organization – tone at the top matters” - Thomas Totton, General Manager – Internal Audit, Bank Muscat

Despite the practical challenges, internal audit functions should endeavor to conduct audit of culture and ethics as these practices set the basis for the organization’s approach towards risk management, governance and controls. Even best in class framework, systems and processes may fail if the organization does not have the right culture. While challenging, some of the techniques that are being followed include establishing and review of indicators of effectiveness of culture/ethics, and review of soft controls such as board oversight, board & executive management commitment to policies on ethics and integrity, organizational surveys on culture & ethical practices. Audit of ethics & culture extends beyond processes and policies and should include assessment of quantitative and quantitative factors.
Performance Auditing

Performance audits focus on organizations ability and extent of achievement of its objectives as against the established plans and strategies. It covers whether the organization as a whole has achieved or is in a position to achieve the objectives as well as whether the individual business units, and functions are achieving their objectives to drive and support the achievement of overall objectives of the organizations.

Just over 50% of internal audit functions seem to carry out performance audits. However, the extent of coverage of performance audits is fairly less in majority of the internal audit functions. For instance, in around 50% of the cases, coverage of performance audits is less than 25%.

"Performance reviews are essential to provide assurance on how the organization achieves its strategic objectives and is also required by the IIA standards. Whether the organization is achieving its objective? This is the assurance the board requires from Internal Audit function more than any other areas. CAEs should have clarity on what they mean by performance audit and what assurance they would want to provide with regard to organization and business unit performance. Performance audits could focus on several aspects such as achievement of business targets, income leakage, and cost saving opportunities. CAEs ability to carry out performance audit also depends on reporting line, positioning, and independence" – Thomas Totton, General Manager – Internal Audit, Bank Muscat

<table>
<thead>
<tr>
<th>Description</th>
<th>None</th>
<th>Minimal</th>
<th>Moderate</th>
<th>Extensive</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reviews addressing linkage of strategy and performance</td>
<td>19%</td>
<td>25%</td>
<td>35%</td>
<td>21%</td>
</tr>
</tbody>
</table>

6.4 Percentage of internal audit resources were used to conduct performance audits (or value-for-money audits) in the past calendar year

<table>
<thead>
<tr>
<th></th>
<th>GCC</th>
</tr>
</thead>
<tbody>
<tr>
<td>less than 10%</td>
<td>13%</td>
</tr>
<tr>
<td>10% to 24%</td>
<td>38%</td>
</tr>
<tr>
<td>25% to 49%</td>
<td>22%</td>
</tr>
<tr>
<td>50% to 74%</td>
<td>22%</td>
</tr>
<tr>
<td>75% to 100%</td>
<td>6%</td>
</tr>
</tbody>
</table>

In the past calendar year, did your internal audit department conduct performance audits (or value-for-money audits)?

<table>
<thead>
<tr>
<th></th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>48%</td>
</tr>
<tr>
<td>No</td>
<td>52%</td>
</tr>
</tbody>
</table>
Internal audit functions should extend beyond risks, governance and processes and should also focus on organizational performance as well as performance of individual business units, functions and processes. Elements of performance should be covered in the individual audits carried out by assessing what the objectives of the area being audited are, and how it aligns to the organizational objectives, and whether/to what extent those objectives are achieved. Periodically review of overall organizational performance and financial position should be carried out to assess whether the achievement of shareholders value creation and growth objectives are on track.

"Performance reviews are essential to provide assurance on how the organization achieves its strategic objectives and is also required by the IIA standards. Whether the organization is achieving its objective? This is the assurance board requires from Internal Audit function than any other areas. Organizations are increasingly undergoing business transformation and it is important that Internal Audit is engaged and at an early stage of this process can contribute and add value as an advisor" - Andrew Garrett, Partner & Internal Audit Services Leader, PwC Middle East

In addition to the above areas of focus there are many other emerging areas where internal audit functions can add value. Such domains include business transformation and restructuring, strategic planning and continuous auditing.

"Organizations are increasingly undergoing business transformation and it is important that Internal Audit is engaged and at an early stage of this process can contribute and add value as an advisor" - Andrew Garrett, Partner & Internal Audit Services Leader, PwC Middle East
Strategic Planning

Planning is essential for any organizations to succeed. Organizations with a robust strategic planning process are able to achieve or exceed their objectives and minimize the impact of occurrence of major risks. It is difficult for any organization to function without any planning or vision. However, in many organizations it could be very formal particularly in smaller firms.

“Every organization regardless of its size and complexity should have a strategic plan in place which should reflect the complexities of the organization, its markets and the environment in which it operates. The strategic plan should outline how the organization plans to exploit the opportunities and take advantage of risks by channeling its resources and people effectively and planning how to respond to crisis. In my view strategic planning is more relevant for less structured smaller private company than a well-structured large companies.

CAEs should earn the respect and credibility to invite participation in discussions on strategic plan and matters of strategic importance. However, care needs to be taken to avoid any potential impairment to objectivity and independence through such participations win executive decision making process. Therefore, it could be better to stay away” - Thomas Totton, General Manager – Internal Audit, Bank Muscat.

“CAEs should assess the strategic planning process to provide assurance as to whether the process of strategic planning is robust enough to capture inputs from relevant sources, been properly reviewed and approved, and that the strategy is properly placing the company in the market” - Asem Al Naser, Chief Audit Executive, Qatar Navigation Q.S.C.

The role of the internal audit function in strategic planning would be primarily to review the adequacy and effectiveness of the process. Where organizations do not have a formal process for strategic planning, the responsibility of the CAE is even more to advise management on the need for such a robust process and help them during the various stages of the process.
Section 7: Managing Expectations and Demonstrating Performance
This section analyses metrics and KPIs used by internal audit functions for measuring and reporting performance.

**Performance Measures in Practice**

Formally defined Key Performance Indicators are not in place in many internal audit departments in the GCC (49%). Top performance measures in place include percentage of audit plan complete, timely closure of audit issues, completion of mandated coverage, Client satisfaction goals, and budget to actual audit hours. These are predominantly restricted to operational efficiency and no metrics seems to be in place to measure adequacy of risk coverage and level of assurance provided.

**7.1 Top measures used to evaluate the performance of internal audit function**

<table>
<thead>
<tr>
<th>Measure</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Client satisfaction goals</td>
<td>40%</td>
</tr>
<tr>
<td>Completion of mandated coverage</td>
<td>30%</td>
</tr>
<tr>
<td>Timely closure of audit issues</td>
<td>40%</td>
</tr>
<tr>
<td>Percentage of audit plan complete</td>
<td>40%</td>
</tr>
</tbody>
</table>

Methodologies used to measure performance include survey of audit clients, internal quality assessments initiated by internal audit, surveys of key stakeholders, and balanced scorecard.

**7.2 Top methodologies and tools used to support quality and performance processes**

<table>
<thead>
<tr>
<th>Methodology</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reviews by your organization's internal</td>
<td>20%</td>
</tr>
<tr>
<td>Reviews from external regulators</td>
<td>30%</td>
</tr>
<tr>
<td>Peer reviews</td>
<td>20%</td>
</tr>
<tr>
<td>External quality assessments initiated by</td>
<td>30%</td>
</tr>
<tr>
<td>Balanced scorecard</td>
<td>30%</td>
</tr>
<tr>
<td>Surveys of key stakeholders</td>
<td>40%</td>
</tr>
<tr>
<td>Internal quality assessments initiated by</td>
<td>20%</td>
</tr>
<tr>
<td>Surveys of audit clients</td>
<td>30%</td>
</tr>
</tbody>
</table>

Performance measures and KPIs are significantly important not just to measure contribution of internal audit function but also to align Board and Management’s expectations from internal audit function. The process of setting the objectives and KPIs will enable the CEO to clearly communicate what "value" internal audit function is mean to bring to the table and the ways and means of achieving it.
Globally there seems no metrics to measure the key area where internal audit brings value i.e. currently there is no basis to measure how and to what extent the internal audit function has identified and assessed the risks; extent of coverage of risks through assurance activities, contributions to improving governance and controls. Establishing metrics to measure contribution in these areas is very challenging considering the subjectivity. It is time for the profession as a whole to work on this aspect.

“It’s very challenging to have a metric to reflect internal audit’s contribution to assurance and improvements to Governance, Risk Management, and Controls” - Asem Al Naser, Chief Audit Executive, Qatar Navigation Q.S.C.

It is critical for internal audit functions to keep track of the contributions it makes to the organization’s improvement and to report these to the Board/Audit Committee. These includes but not limited key risks/issues uncovered by internal audit functions, improvement of key controls through implementation of internal audit recommendations, contributions to organizational governance and risk management practices through assurance and consulting/facilitation work, frauds detected, revenue enhancement opportunities identified and cost savings.

“CAEs should ensure that they have adequate mechanism in place to track and highlight the value they have added to the organization and ensure that those KPI’s are being tracked and communicated to the Board and Executive Management. “Internal audit reports and periodic reporting to the Board/AC should reflect enhancement to GRC ideally with comparison of the status before and after audit. Two important KPIs that could be used are – percentage of recommendations acceptance by management; and the percentage of implementation of such recommendations” - Asem Al Naser, Chief Audit Executive, Qatar Navigation Q.S.C.

“Measuring effectiveness of assurance is very important, yet very challenging. Using 360-degree feedback in evaluating internal audit’s effectiveness is one of the methods that could be resorted to. Feedback may be obtained from the relevant stakeholders including the Board/Audit Committee, Executive Management, and Auditees. The key question high in the minds of Audit Committee/Board members is “how effective is the risk identification process and audit plan execution deployed by the Audit function to mitigate such risks” - Dr. Khalid. Al-Faddagh, Vice Chairman, Audit Oversight Committee, King Fahad University for Petroleum and Minerals
Conclusion
The success of any internal audit function will depend on its ability to understand and align internal audit activities to meet stakeholder’s expectations. The stakeholders vary depending on the nature and type of organization and so do the expectations placed on the internal audit function. It is important to manage expectations of the stakeholders relating to the role of internal audit function and how the internal audit function can add value to the organization. The results of the survey provide several takeaways for CAEs and internal audit practitioners that can help improve the effectiveness of the internal audit function:

- **Functional reporting of internal audit function to the Board/Audit Committee** does not necessarily guarantee the proper positioning, independence and authority expected for internal audit function to be effective. Administrative reporting and decision making authority in the appointment, termination, performance evaluation, and reward of the CAE (as well as staff of internal audit function) has an impact on the independence and authority of the internal audit function. Ideally all these powers should vest with the Board or Audit Committee.

 "Regardless of internal audit’s functional reporting to the Board/Audit Committee, in practical terms, CAE’s role is essentially to support the CEOs in providing insights, advice and assurance on Governance, Risk, and Controls. CAEs should work towards earning the trust, respect, credibility, and reliance of the CEOs” – Aley Raza, Chief Ethics and Compliance Officer/Director Internal Audit, ENOC

- **Internal audit functions should not deviate from the primary role as an assurance provider within the third line of defense.** However, this may not be the reality in some organizations and specifically in family owned businesses where internal audit functions could even be perceived as the prime owner for preventing/mitigating risks including prevention and detection of frauds. In such circumstances, internal audit functions should seek to remain flexible and should direct their activities to meet the stakeholders’ expectations while educating senior management and the board on management’s responsibilities as they relate to risk management.

- **Internal audit functions should align their activities to the strategic objectives and plans of their organizations.** Overall the survey results and the analysis provide ample evidence on the limited focus of internal audit function on strategic risks, risk management effectiveness, and organizational governance. Internal audit functions should look at the bigger picture and should allocate appropriate time and resources to auditing strategic risks, risk management effectiveness and organizational governance.

- It is important to keep track of changing internal and external business environment and the changes in organization’s risk profile. The internal audit functions should adopt a flexible approach to risk assessment and planning. Risk assessments should be done at least annually with periodic review to update the risks/changes. Similarly, a flexible approach to internal audit planning is required to accommodate changing circumstances and priorities.

- Internal audit functions should ensure that the requirements of IPPF are followed in letter and in spirit and should also adopt a robust Quality Assurance and Improvement Program which should include internal and external assessments.

- To be successful, internal audit functions should be resourced with competent people with the right skills and experience. Skills needed for internal audit functions should not be limited to audit and financial accounting/reporting skills but should also include business acumen, and industry specific technical skills need to understand the business, risks, and to challenge management where
needed. While there are challenges to have all required skills in-house, it can be managed through use of external service providers. Besides, the skills of the internal audit function should be developed through staff rotation, and formal training/professional development plan.

- Internal audit functions should adopt leading practices that make a difference to the organization, some of which are expected to receive increased attention in the future. Some of the areas which are gaining importance include auditing sustainability, audits of culture and ethics, adopting a combined assurance model, and participation in business transformation.

- Last but not least, internal audit functions should have in place robust mechanism to measure and report their performance. Internal audit functions should establish strong communication channels with the relevant stakeholders and should periodically report on internal audit functions contribution. This also calls for having in place appropriate measures/metrics to measure performance and to assess the effectiveness of discharge of the internal audit function’s responsibilities.

Establishing a successful and effective internal audit function is not without challenges. The main challenges include immature corporate culture and organizational practices, limited understanding of importance of governance and risk management resulting in lack of support from the board or management to promote best organizational practices. However, these challenges make the role of CAE more important in such circumstances.

CAEs should take the responsibility for promoting awareness and understanding of sound corporate and governance practices to push the organization to move up the maturity ladder. This could be achieved by education, training, and constant communication with the stakeholders to manage expectations. CAEs should build a right image for the internal audit function which can only be achieved by positive contributions such as highlighting critical risks/issues, providing concrete recommendations/solutions to address such risks, and helping business improve. It is also critical for the internal audit function to remain proactive to highlight risks and issues as and when they occur. This calls for adopting leading practices such as continuous auditing, and use of data analytics/technology in auditing.

"CAEs ability to have access to the Audit Committee/board is quite critical for the effective functioning of internal audit. Even though the Audit Committee will give sufficient time for Internal Audit results, it is also important for the CAEs to focus on value add and strategic issues that matter to Audit Committee/Board and executive management. CAE’s should engage with the Audit Committee/Board/Executive Management to understand their expectations and should direct the audit function and resources to focus on key areas of high concern to the stakeholders" - Gautam Gandhi, Group Risk and Internal Audit Manager, Al Fahim Group

"It’s a challenge to gain reputation; it can only be achieved by demonstrating value. There are two factors that are essential in this regard; one, having the right competencies, and two, demonstrating objectivity. Internal Auditors should have the competencies to understand Corporate Strategies and Objectives; demonstrate value through making objective recommendations and ensuring implementation of such recommendations" - Dr. Khalid. Al-Faddagh, Vice Chairman, Audit Oversight Committee, King Fahad University for Petroleum and Minerals
Details of the 918 internal auditors who participated (Note: Response rates vary per question) in this study are as follows:

**Survey Participants by Country**

- Bahrain
- Kuwait
- Oman
- Qatar
- United Arab Emirates
- Saudi Arabia

**Survey Participants by Staff Level**

- CAE (Chief Audit Executive) or Equivalent
- Director or Senior Manager
- Manager
- Staff
Survey Participants by Type of Organization

- Privately held (non-listed) organization
- Publicly traded (listed) organization
- Public sector (including government agencies and government-owned organization
- Not-for-profit organization (not related to government)
- Other

Company Size of Survey Participants in Revenue

- More than $100 million up to $1 billion
- More than $1 billion up to $10 billion
- More than $10 billion
- $1 billion or less

Company Size of Survey Participants in Number of Employees

- 1,501 to 10,000
- Less than 500
- 500 to 1,500
- 10,001 to 100,000
- 100,001 to 2,250,000