

Advisory Services
Internal Audit

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Asia Pacific Supplement

Dynamic and significant change ahead

In Asia Pacific, there is clear agreement among internal audit leaders that significant change will characterise auditing environments in this region for years to come, a direct reflection of strong economic growth. Competition is intense as more and more companies expand and go public, increasing regulatory oversight and placing greater pressure on internal control frameworks and those responsible for them.

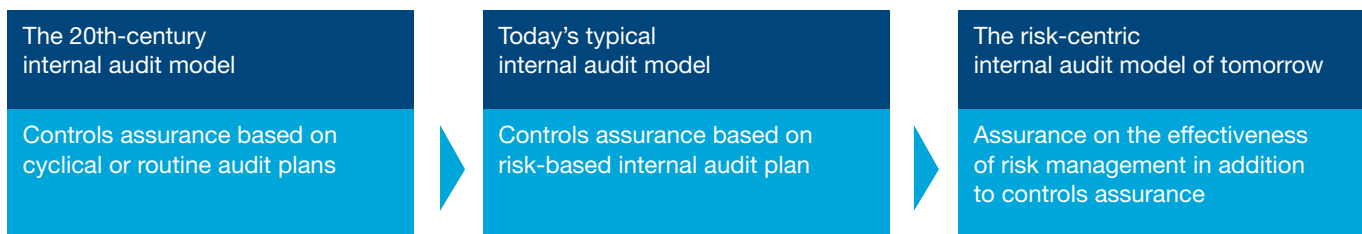
A PricewaterhouseCoopers' survey of internal audit leaders in Asia Pacific suggests that internal audit functions in this region will soon experience stepped-up requests for assistance from their chief stakeholders. Directors and executive management alike are turning to internal audit and other staff functions for help in the areas of corporate governance, risk management, fraud prevention and detection, and ethics, as well as internal controls. At this point, however, relatively few Asia Pacific internal audit groups have made the necessary adaptations to respond effectively to such requests.

Choosing a new, strategic path

Between now and 2012, the controls-focused approach that has dominated internal audit functions on a global basis is expected to diminish significantly in value. As this change occurs, internal audit leaders in Asia Pacific will need to redefine their fundamental value propositions and adopt risk-centric mindsets if they expect to remain key players in assurance and risk management.

In today's global marketplace, internal audit groups find themselves at a strategic crossroads with two primary options: They can pursue the status quo, a path that could lead to functional obsolescence. Or they can take a risk-centric, strategic approach to their work, moving beyond the fundamentals of risk and controls to create a new value proposition wherein internal audit provides risk management assurance as well as assurance over controls (see Figure 1). Without question, the latter, strategic path is more likely to address the changing needs of Asia Pacific organisations and meet the rising expectations of senior management and audit committees.

Figure 1: The shifting focus of internal audit

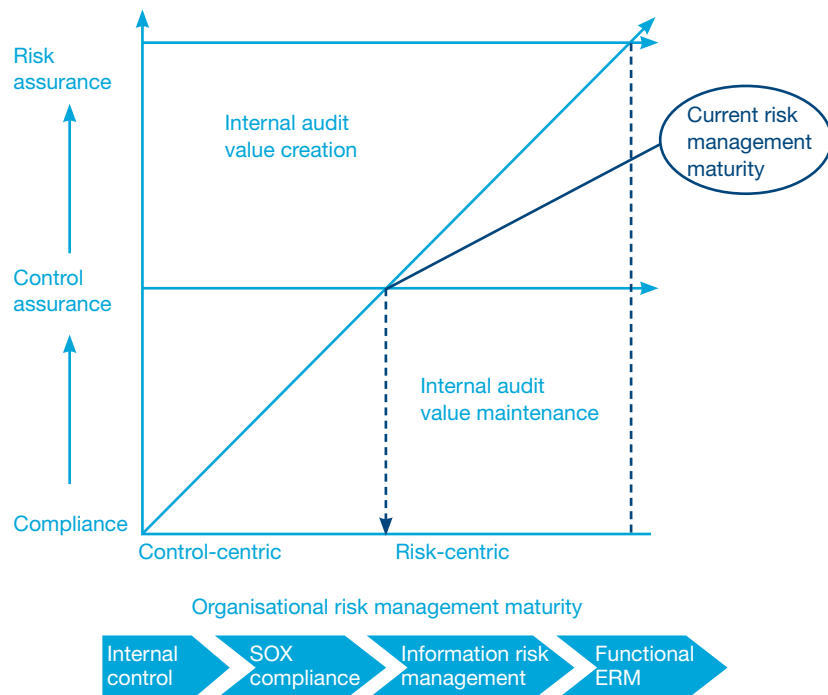


For internal auditors, adopting a risk-centric mindset means taking an all-inclusive, conceptual approach to audit, risk assessment and risk management that extends well beyond a narrow focus on controls. With such a mindset, internal auditors can increase their functional value at a time when risk assessment and risk management have become primary stakeholder concerns.

Moving quickly to improve risk management maturity

According to our research, internal auditors within Asia Pacific continue to focus primarily on compliance and control issues as opposed to risk. For historical and cultural reasons, audit leaders in this region have yet to adopt the risk-centric mindsets and related capabilities needed to address the mounting risk concerns of directors and senior management. As a result, internal audit functions in Asia Pacific are generally less advanced than those of US companies. As internal audit functions move up the left axis of the Internal Audit 2012 Value Model (see Figure 2), they evolve from a primary focus on compliance to focus first on control assurance and then on risk assurance.

Figure 2: Internal Audit 2012 Value Model



As Asian companies seek to become more global, they will be expected to have the types of advanced control and governance processes typically found in the US, Canada, and Europe. Without such advanced processes, Asia Pacific companies will find it more difficult to compete effectively in global capital markets. To help their companies achieve such advanced levels of control and governance, internal auditors in this region need to progress as quickly as possible along the risk management maturity axis of the Internal Audit 2012 Value Model. However, that's no small feat, because an internal audit function cannot change its primary orientation overnight. To move from a compliance orientation to an effective focus on risk assurance, you must first master the second stage, control assurance.

In global capital markets, the quality of a company's internal audit, control, and governance processes can either provide significant competitive advantage or be a major liability. At this point, internal auditors in Asia Pacific need to recognise that they are well behind many of their US peers in terms of process quality. In addition, they need to keep in mind that while they are trying to catch up with their US peers on the risk-management curve, internal auditors in the US are probably moving beyond a preoccupation with controls to focus squarely on risk assurance.

The bottom line: Time is short; either move quickly to embrace a risk-centric approach to assurance or risk losing further ground to your global competitors.

Capitalising on opportunities

As our research indicates, internal auditors in Asia Pacific face a number of obstacles in their drive to strengthen their positioning.

- Due to their compliance focus, they often lack strong connections with executive management – an essential element in enhancing functional value
- Cultural norms in some Asia Pacific countries tend to inhibit promotion of a dynamic and independent role for internal audit
- A number of large organisations in the region either have no internal audit function whatsoever or have an internal audit function that focuses on low-value activities such as double-checking expense report reviews or monitoring bank reconciliations
- Internal audit functions in Asia Pacific will often issue reports with watered-down findings and without recommendations for improvement in order to avoid upsetting or embarrassing their auditees
- The corporate managements of Asia Pacific are often slow to demand a stronger internal audit function

As Asia Pacific companies assume multinational status, however, they quickly realise the value and benefit of a robust internal audit function aligned strongly with the strategic direction of the organisation. To this point, sixty-eight percent of our Asia Pacific respondents believe that the role of the chief audit executive at their companies will increase over the next five years compared with only a 10 percent projection from US respondents.

As one Asia Pacific internal audit leader we interviewed said, *“There has never been a better time to be an internal auditor.”*

Survey Methodology

Since 2005, PricewaterhouseCoopers has been conducting an annual “State of the Profession” survey to provide internal audit leaders important data and insights about current issues affecting the internal audit community. Considering the many forces impacting internal audit in recent years, we thought it would be beneficial to develop a consensus projection of the trends likely to shape the world of internal audit by the year 2012. To pursue this goal, PwC surveyed the chief audit executives of US Fortune 250 companies and a number of internal audit specialists about trends likely to affect internal auditors over the next five years. Being mindful of the extraordinary changes occurring across the Asia Pacific region, PwC also conducted a regional survey of Asia Pacific internal audit leaders to gain their perspectives regarding important trends as well as their expectations for internal audit in the years ahead. We are very grateful to those who participated in our research.

The following table summarises our methodology used in the two surveys.

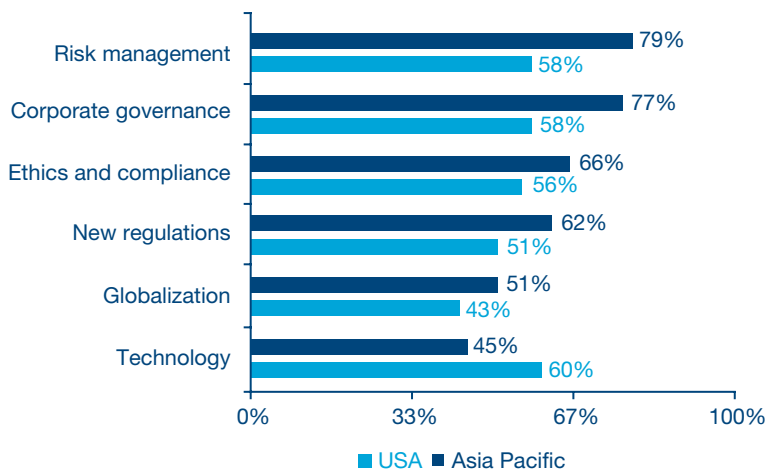
	Asia Pacific	US
Survey Population	Chief internal auditors at 50 selected large companies from 13 Asia Pacific countries	Chief internal auditors at 72 of the US Fortune 250, plus selected thought leaders, academics and stakeholders
Interviews	10	19

Given the relative immaturity of internal audit functions in Asia Pacific, it was not surprising to note that our survey respondents across this region expect significantly greater change over the next five years than do their peers in the US. The remainder of this report summarises the key findings from the Asia Pacific survey with appropriate comparisons to the US survey results.

External Trends

The internal audit leaders of the US and Asia Pacific agree that the increased focus on corporate governance, risk management and ethics will continue and will greatly impact internal auditing over the next five years. Internal audit leaders rated the following trends as having the most impact on the roles and responsibilities of internal audit over the next five years:¹

Figure 3: Trends Affecting Internal Audit



As Figure 3 reflects, Asia Pacific leaders believe that these trends will generally have a greater impact on internal audit than do our US survey respondents. The reasons are many. For starters, there appears to be a greater expectation among Asia Pacific stakeholders for internal audit to be more proactively involved in helping their business operations. Another factor is the increased level of regulation across the Asia Pacific region. More and more countries in this area are enacting legislation to promote better corporate governance and more transparent financial reporting. For example, countries such as Japan, Korea, India and China have developed regulatory frameworks governing internal controls that are similar to the regulations put in place in the US following enactment of the Sarbanes-Oxley Act of 2002. Furthermore, all state-owned enterprises in China are now required to implement an enterprise risk management system, and listed companies in India are now required to control risks through means of a risk management framework.

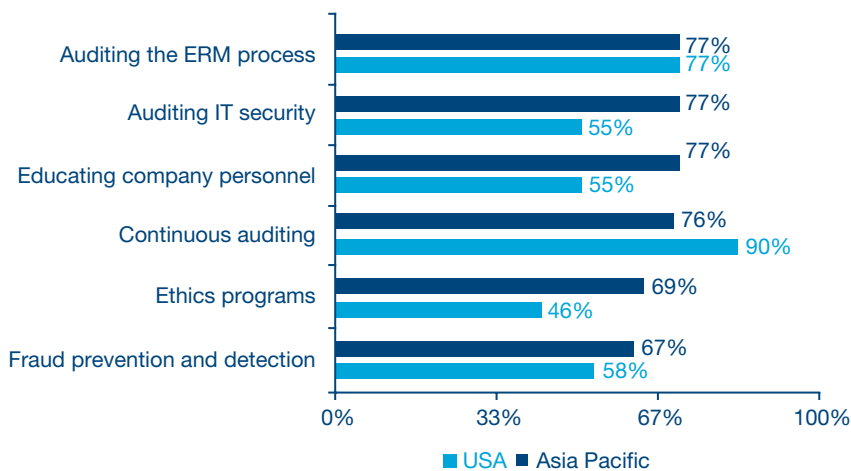
Globalisation is truly affecting all parties as the barriers to worldwide commerce become easier to surmount. However, US respondents appear to be more concerned about technology than their Asia Pacific counterparts, in part because of the challenges associated with ongoing efforts to lower costs through new technological applications, such as tagging goods with wireless radio frequency transmitters and equipping employees with personal digital assistants (PDAs).

¹ The percentage of respondents who expect a particular trend to have either a strong or very strong impact on their internal audit functions over the next five years.

Roles and Responsibilities

When we asked internal auditors in the US and Asia Pacific where they expected to spend more time five years from now, the results were mixed, as shown in Figure 4 below.²

Figure 4: Areas of increasing responsibility



Asia Pacific and US respondents agree that risk management will be a key focus moving forward. To address risk concerns, internal audit leaders we interviewed in both regions said they plan to update their risk assessments on a more frequent basis. They also plan to take a shorter-term approach to audit planning in order to gain both flexibility and agility and to ensure that their internal audits are on target.

Survey respondents in both the US and Asia Pacific believe continuous auditing offers significant promise. Some internal audit leaders cited the ability to use continuous audits to zero in quickly on riskier events at lower cost. “The challenge is to figure out where to look and what to look at,” said one Asia Pacific internal audit leader. For many companies, continuous auditing routines have become an integral part of their audit plans.

Internal audit leaders in Asia Pacific expect to spend more time relative to their American counterparts on IT security. Across Asia Pacific, companies are upgrading their information systems and shifting to a higher mix of automated controls as opposed to manual ones. By doing so, there will be a corresponding increase in the time required to review IT strategy and ERP implementations.

² The percentage of respondents who expect a particular factor to generate either somewhat more or much more responsibility for internal audit over the next five years.

Internal audit leaders in Asia Pacific also expect to spend much more time relative to their American peers on educating company personnel about internal controls and ethics programs. Some parts of Asia Pacific face significant challenges to change attitudes and behaviors, as well as to develop modern legal systems. For example, China recently created a clear legal precedent that defines the bribery of government officials to include acts such as providing company shares as gifts, selling property such as houses or automobiles at below-market prices, and fixing gambling games.

In the US, companies have been adopting offshoring and outsourcing as ways to cut costs. Thus US audit leaders expect to be more involved than their Asia Pacific peers in auditing offshored and outsourced operations, a trend expected to translate into more internal auditing opportunities for Asian-based internal auditors because of the rapid growth of commerce in the Asia Pacific region.

US respondents also expect to spend more time than their Asian-Pacific counterparts on the various ways that the rapid proliferation of technology is impacting their organisations as well as their internal audit functions. Risks associated with protecting all types of company data, already a significant concern to internal auditors in the US, is expected to become a major concern among their peers in the Asia Pacific in the not-too-distant future.

Stakeholder Interactions

The fact that internal audit functions in the Asia Pacific region are not as advanced as their US counterparts is strongly reflected by survey results dealing with stakeholder dynamics. The following table shows the percentage of survey respondents who expect that the importance of their stakeholder relationships will increase over the next five years.³

	Asia Pacific	US
Audit committee	87%	10%
Executive management	79%	17%
External auditors	73%	3%

Between now and 2012, internal auditors in Asia Pacific clearly expect to be far more engaged with their internal audit stakeholders as they continue to emulate their counterparts in the US, many of whom have already achieved this milestone. With regard to relations with external auditors, Asia Pacific respondents expect the focus to be on risk assessment as opposed to coordinating an integrated audit plan, a common focus of internal auditors in the US.

When asked about the importance of internal audit stakeholders in 2012, however, US respondents rated business-unit management and executives other than the CEO and CFO more highly than did their peers in Asia Pacific.⁴

	Asia Pacific	US
Audit committee	1	1
Full board of directors	2	7
CEO	3	3
CFO	4	2
External auditors	5	5
Shareholders	6	8
Business unit management	7	4
Other executive management	8	6

By more than a two to one margin, Asia Pacific internal auditors expect to report administratively to the board of directors or the chief executive officer as opposed to the CFO. In addition, the majority of Asia Pacific respondents expect greater demands from stakeholders to issue some type of annual entity-wide opinion about the adequacy of internal controls at their respective organisations. Sixty-three percent of internal audit leaders in the Asia Pacific region expect this to occur compared with 40 percent in the US.

³ The percentage of respondents who expect a particular internal audit stakeholder to demand more in terms of the extent and frequency of communications from internal audit over the next five years.

⁴ The relative ranking of the respondents' replies regarding the expected importance of stakeholders in 2012.

Skill Sets

It is noteworthy that when the two survey populations were given a long list of 22 different internal audit skill sets to consider as being more important in 2012, they agreed on the top 15. Indeed, they put them in the same general order of preference.

The top five skill sets, in their order of rank, are as follows:

1. Data mining
2. Risk assessment
3. Information technology
4. Risk management
5. Fraud detection

However, when asked what types of IT skills internal auditors will need in 2012, the expectations of our survey respondents differed.

Asia Pacific	US
1. Corporate IT strategy	1. Offshored IT operations
2. IT systems development and implementation	2. Data privacy risks
3. ERP systems	3. ERP systems
4. Systems information integrity	4. Data warehouse controls
5. Contingency planning and disaster recovery	5. Systems information integrity

Working Practices

Like their US counterparts, internal auditors in the Asia Pacific region expect to apply technology to increase the efficiency of the internal audit process. The three most common type of tools mentioned by Asia Pacific internal audit leaders were electronic workpapers, data analysis programs, and network security tools.

In a number of respects, trends in internal audit working practices in the US are of growing interest to the internal audit community in Asia Pacific:

- US respondents perceive a greater need for a framework to improve the definition and management of IT risks. However, US survey respondents did not agree on which framework (CobiT, COSO, or other) would be most appropriate.
- Internal auditors in the US predict an increase in the use of ratings to summarise the severity of internal audit findings.
- The use of balanced scorecards and other formal measures to assess the effectiveness of internal audit is more prevalent in the US
- Among US respondents, there is a greater likelihood of using some type of Quality Assurance Review (QAR) to benchmark internal audit functions.

Next Steps

It's an exciting time to be an internal auditor in Asia Pacific. The expectations of internal audit stakeholders are at an all-time high. Significant opportunities abound for internal audit leaders to be more engaged with executive management and the board of directors.

We believe internal audit functions must be proactive and redefine their value to their organisations. It is vital for internal auditors in Asia Pacific to learn from the experiences of their peers in other regions of the world. Take advantage of new tools and techniques to make the most of today's opportunities.

In the PwC study, [Internal Audit 2012](#), you will gain valuable insights for improving your internal audit function and the internal audit profession as a whole. You will also find a series of specific recommendations as set out below.

- How to strengthen compliance with the requirements of the US Foreign Corrupt Practices Act of 1977 and the UN Convention Against Corruption
- Improving the perception of internal audit
- Strategic initiatives to become more risk-centric
- How to improve risk assessments and audit plans
- Leveraging technology
- Addressing talent and organisational issues
- Strengthening anti-fraud programs
- Implementing continuous auditing techniques
- Aligning internal audit priorities with stakeholder expectations
- You will also find PwC's *Imperatives for Internal Audit Success*, a ten step process for building a high-performance internal audit function in the years ahead.

Let us know if you have any questions or issues to discuss. We look forward to your feedback.

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