Internal Audit in Croatia

Market Survey 2009
Content
Introduction
An overview of Internal Audit in Croatia

The objective of this survey was to provide the Croatian market with an overview of the organisation and practices of the Internal Audit function in Croatian companies and, at the same time, to provide an independent analysis of key trends and emerging issues regarding many aspects of the Internal Audit function in various industry segments of the Croatian market. The results of the survey are intended to assist Croatian companies by providing peer benchmarks. We believe that this will allow identification of best practices and areas for improvement and will help internal auditors prepare for future challenges.

Scope of survey

The survey was designed to cover both qualitative and quantitative aspects of the Internal Audit function that are currently in place. This report has been organized around Internal-Audit-related areas that represent the basis of the survey questionnaire, covering the following areas: Organisation, Expectations, Working practices, Quality, and Other matters.

Survey methodology

Each section of this report includes an analysis of the survey results and a discussion of the underlying issues. Tables and charts are presented to help the reader quickly ascertain the main findings and issues associated with each topic, and to assist in the benchmarking of the respective organisation’s practices.

The survey was administered both in electronic form via email responses and in paper form via fax and mail responses.

Response base

The survey was conducted in May and June 2009. It was organised as a joint initiative between PricewaterhouseCoopers d.o.o. and the Croatian Institute of Internal Auditors (HIIR).

We emailed the survey questionnaires to 122 companies in the Croatian market of various sizes and within different industries and we received 42 responses, which is a 34% response rate.

Survey confidentiality

The survey results are presented in this report on a no-name basis. Each company’s individual results have been kept strictly confidential, and peer responses have been presented in a way that will not allow identification of any specific company based on its submitted data. The results are based solely on survey responses as provided by each company participant and publicly available information about these companies. We have not subjected the data in this report to audit, review or compilation procedures or any other testing to validate the accuracy or reasonableness of the data provided by the participating companies. None of the results that we received from any individual company has or will be published or otherwise disclose individually.

A word of thanks

We would like to thank those companies that participated in this study. We believe that you will find the survey results insightful, and we hope that they serve as a catalyst for discussion and action within your company.
### Highlights

<table>
<thead>
<tr>
<th>Percentage</th>
<th>Description</th>
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<tbody>
<tr>
<td>84%</td>
<td>of organisations perform Internal Audit activities using in-house resources from Croatia</td>
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<tr>
<td>76%</td>
<td>of respondents believe that the IA function has an appropriately important status in their organization</td>
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<tr>
<td>65%</td>
<td>of respondents believe that their Internal Audit function gives a high benefit at a low cost</td>
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<tr>
<td>89%</td>
<td>of respondents confirm that they follow the IIA standards</td>
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<tr>
<td>35%</td>
<td>of Internal Audit staff do not have certification</td>
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<tr>
<td>27%</td>
<td>of Internal Audit Heads consider insufficient communication with management to be their primary concern</td>
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Main observations

Internal audit organization

Based on a market survey we conducted, 84% of the respondents have an Internal Audit (IA) function in Croatia, and most IA departments outside the financial industry are fairly small. Almost one third of the respondents have an IA group of one auditor, while another third of respondents have an IA group of five or more auditors (mainly in the financial industry and public sector).

We analysed data regarding the number of internal auditors in relation to the size of the company in terms of the number of employees. We discovered that this relation is most apparent in the financial sector.

In addition, the number of employees per internal auditor is lower in the banking industry (125 employees per internal auditor) than in the insurance industry (300 employees per internal auditor). For all other industries, the relation of the size of the company (in terms of the number of employees) and the number of internal auditors is visible only to a certain extent.

The evident relation of the number of internal auditors and the size of the company in the financial sector may be caused by the fact that banks, in general, have a standard structure, with similar processes. In contrast, other industries differ in terms of organisation structure, processes, products and the risks arising therein. In addition, the financial sector is regulated more heavily than other industries, leading to the earlier establishment and development of internal audit functions.

Almost all organisations have at least one or more IA staff with local certifications, over one third of IA staff across all organisations has no specific certifications.

Many companies face the challenge of determining the appropriate IA group size and structure in order to ensure the effectiveness and efficiency of the Internal Audit function. Determining the optimum staffing level and structure for the IA function is a matter of identifying properly the factors to be considered (such as risks and business goals of each individual company).

Reporting lines

The majority of the Internal Audit heads (Chief audit executives) that responded report to the executive management. However, functional and administrative reporting should be distinguished. The IIA believes that, in order to achieve necessary independence, the ideal reporting line of the Chief audit executive (CAE) is to report functionally to the Audit Committee or its equivalent, and administratively to the CEO.

The survey reveals that in a number of organisations the Internal Audit function lacks full support within the organisation (1 in 4 respondents believe there is insufficient support and that management does not appreciate the value). A quarter of respondents indicated "internal acceptance and support" as their most significant challenge. Going forward, Internal Audit function will need to increasingly consider the value they bring to the business and how this value is communicated and leveraged within the organisation.

Adherence to IIA Standards

A total of 89% of the companies responded that they follow the standards of the Institute of Internal Auditors. However, this percentage does not represent full compliance, as only 18% of the respondents confirmed complete compliance with Standard 1311 (Internal Assessments), and only 8% confirmed complete compliance with Standard 1312 (External Assessments). An external assessment is a good opportunity to benchmark internal audit processes against leading practices.

In general, we can conclude that full adherence to the Standards is low and is a topic to be considered for future improvements in Internal Audit practices and in the understanding of IIA Standards and principles.
The most important contribution of the IA function

“Improved operating efficiency” and “internal controls procedures” were considered by respondents to be the most important contributions made by their Internal Audit function. This fact is in line with the basic definition and main objective of the Internal Audit function. This indicates that the development of the IA function in the Croatian market is proceeding appropriately.

Companies operating in more developed markets see it much more as a function that could and should deliver efficiency, effectiveness, and strategic value.

Certainly achieving these benefits requires investment first – investment in Internal Audit’s human resources, processes and infrastructure. To manage these three crucial pillars properly and efficiently, it is essential:

- to make every effort to motivate staff to obtain appropriate qualifications and keep them up to date with new Internal Audit tools and methods;
- to implement IIA standards properly and assure staff’s full understanding in all respects;
- to carry out an external Quality Assurance Review to attract the attention of key stakeholders and enhance the strategic performance of Internal Audit.
General information
General information

In the graphs below, you can find a detailed analysis of the response rate and the response base by industry segment and turnover category. The majority of companies participating in the survey came from the financial sector (banking and insurance).

With regard to turnover, over half of the companies that responded to our survey were larger organisations with turnover over HRK 500 million and employees over 1,000.

Figure 1: Which industry sector does your company belong to?

Figure 2: What was your organization’s approximate turnover in Croatia for 2008?
A small portion of respondents (11%) indicated they did not have an internal audit function, and no visible trends for underlining reasons were apparent from their responses. The responses from these organisations are excluded from the survey results.
**Organisation of the internal audit function**

Most of the IA groups are very small. 38% of IA departments that responded are represented by a single auditor or two auditors. 40% of the companies have an IA group of three to four people, while 30% have 5 or more auditors in the IA departments.

Considering the number of employees working in the Company, the number of internal auditors does not seem to correlate in all industries in the same way. The relation between the size of the company (in terms of the number of employees) and the number of internal auditors is most apparent in the financial sector. Excluding the very large and small entities, the average number of employees per each internal auditor is 125 in the banking sector and 300 in the insurance sector.

In general, in the organisations outside the financial sector there is no correlation between the number of employees and the number of internal auditors, since this range is very wide and inconsistent compared to the financial sector. On average, the range varies from 450 to 1,000 employees per each internal auditor for those entities that responded to the survey.

![Figure 4: Headcount of your internal audit department](image)

The majority of audit activities (84%) are completed by the Croatian in-house function. Group auditors exclusively or in combination with the local function are involved in all other cases. Regional and global IA research conducted by PwC indicates that the involvement of only in-house IA function is lower since more organisations use a mixture of Group internal auditors and external professional firms. Over 61% of Fortune 1000 companies use some level of internal audit outsourcing.

![Figure 5: Who performs your internal audit work in Croatia?](image)

The benefits of co-sourcing or outsourcing internal audit activities include specialised expertise, expanded audit coverage and access to best practices, thought leadership and business insights.
Reporting to the executive management (President of the Management Board, General Manager and/or management) was the most frequent within the companies. However, it is worth noting that 55% of organisations are responsible to one body or person, while the remaining 45% are responsible to two or more. In comparison to the PwC global IA research, over 90% of global respondents report functionally to the Audit Committee.

In the financial sector (insurance and banking) almost 90% of the entities report to the Supervisory Board. In addition, only in the banking sector more than a half of the entities also report to the Audit Committee.

The majority of respondents think that their Internal Audit function has an appropriately important position in their company. In the banking sector, the percentage of positive answers was very high (89%), while the public sector had the lowest positive response rate (60%).

The functional focus of most internal audit functions is internal controls, process improvements, legal and regulatory compliance and risk management. Almost all respondents gave more than one answer.
In approximately one third of the respondents, there is an Audit Committee which includes middle management. In the banking sector, this percentage is much higher (approximately two-thirds of Audit Committees include middle management).

Figure 9: Middle management representation in Audit Committees

There was a very strong response to the existence of a mission statement (internal audit chapter). This is an important starting point for any Internal Audit function.

Figure 10: There is a mission statement, which defines, in broad terms, the purpose, authority, objectives, and responsibilities of the Internal Audit function.

In comparison to the number of IA staff for all respondents, the majority (57%) has local certificates, while only a small portion of IA staff (8%) has International certificates (CISA, CIA, CISM). Over one third of IA staff (35%) has no certifications. Almost all of the company respondents have at least one or more IA staff with local certification, while approximately half of the companies also have staff with no certification.

Figure 11: How many of your auditors have adequate qualifications?
Two most important contributions made by the internal audit function over the last year are considered to be:

- assistance in achieving company goals
- improved operating efficiency.

Expectations
Two most important contributions made by the Internal Audit function over the last year are considered to be: “improved operating efficiency” and “evaluated internal control procedures and identified weaknesses”, which corresponds to the most important functional focus of IA departments (Figure 8).

Figure 12: What was the most important contribution made by your Internal Audit function over the last year?

27% of the respondents see “insufficient communication between internal audit and key stakeholders (management)” as the main problem which is closely followed by “lack of capable professional staff” in 24% of organisations. In the banking industry, the main problem identified was insufficient utilisation of supporting information technology. Over a quarter of respondents from the public sector indicated lack of office space as one of the top problems.

Figure 13: What has been the main problem of your Internal Audit function?
65% of the Internal Audit functions think that their contribution is high at a low cost, whilst only 3% think that they provide a low benefit at a high cost.

Figure 14: Benefit to cost analysis

Approximately half of the organisations that participated in the survey revealed that the estimated annual budget for internal audit services is up to HRK 500 thousand. In comparison to the annual revenues, the internal audit annual budget on average represents only 0.2% of that amount.

Figure 15: Estimated annual budge for internal audit services

The planned budget for the internal audit function in 2010 will be in 78% of respondents equal to the budget in 2009. Only 5% of organisations have a planned decrease of internal audit budget in 2010. Most of the companies planning a lower budget for 2010 are financial institutions.

Figure 16: Planned budget for internal audit function in 2010
Work practice
Work practice

In the majority of cases, the person responsible for internal audit (Chief Audit Executive, CAE) is appointed by management which is consistent with the fact that most IA functions report to executive management (figure 6). In the banking sector, approximately half of CAEs are appointed by the Supervisory Board, while the remaining are appointed by management. Most of the “Other” responses relate to the public sector which is organised differently from other industries.

Figure 17: Who appoints the CAE or person responsible for internal audit?

The annual risk assessment is prepared by most of the company respondents.

Figure 18: An annual risk assessment plan is prepared to form a basis for audit plan.

The average internal audit cycle lasts one month or less for half of the respondents, while the remaining respondents have audit cycle of less than 6 months (with the exception of 6% of the respondents who have longer audit periods). Shorter audit cycles are more common in the financial industry while companies in the public sector and other industries tend to have longer audit cycles.

Figure 19: Average time of internal audit cycle
Only a quarter of respondents perform a regular skills gap analysis.

**Figure 20**: A skills gap analysis is performed on a regular basis.

In regard to training, an individual training plan exists for internal auditors in 68% of the survey participants.

**Figure 21**: Individual training plan exists for all internal auditors.

Internal Audit functions are increasingly supported by computer-assisted tools. This survey revealed that 65% of the organisations use computer-assisted tools and technologies to perform audit testing. In the public sector, only 40% of respondents use the computer technologies for audit testing.

**Figure 22**: Computer assisted tools and technologies are used to perform audit testing.

92% of respondents declared that their audit working papers are paper based. In addition, half of the participants keep some of their audit working papers in an electronic format. Only a small portion of IA departments use external software for documentation of audit workpapers.

**Figure 23**: The audit working papers are mainly in which format?

65% of respondents stated that Information technologies are a subject of Internal Audit coverage. When excluding banks and insurances (which are required by the Croatian National Bank and the Croatian Financial Services Supervision Agency) to cover information technologies as part of their internal audit scope), the number of IA respondents which cover Information technologies as part of internal audit is reduced to 53%.

**Figure 24**: Information technologies are a subject of Internal Audit coverage.
We have found out that 66% of respondents are following the Standards of the Institute of Internal Auditors.

However, only 14% of the companies declare complete compliance with the Standard 1311.
Quality

89% of respondents stated that they follow the standards of the Institute of Internal Auditors.

Figure 25: Is the Internal Audit function following the standards of the Institute of Internal Auditors?

However, only 18% of organisations confirmed complete compliance with Standard 1311.

Figure 26: Internal Assessments should include (a) ongoing monitoring and (b) periodic internal assessment of Internal Audit performance (Standard 1311).

Appropriate monitoring of the resolution of internal audit observations and recommendations is one of the most important factors with regard to Internal Audit effectiveness.

89% of organisations which participated in the survey think that there is an effective process of monitoring resolution of internal audit observations and recommendations. However, outside the financial industry, approximately one quarter of organisations do not effectively monitor the resolution of internal audit recommendations.

Figure 27: There is an effective process of monitoring the resolution of internal audit observations and recommendations.
Only 19% of the respondents have a formal system for measuring and evaluating Internal Audit's performance, while 81% has only an informal system of measuring and evaluating Internal Audit's performance.

**Figure 28:** There is a formal system of measuring and evaluating Internal Audit's performance.

In participating organisations, internal audit departments measure their performance in various ways, 85% via written or oral feedback from senior management or the Audit Committee, while the smallest percentage, 9%, use a decreased external audit fee. This potentially indicates that external and internal audits may need to improve their communication or further increase the efficiency and mutual coordination of their work.

**Figure 29:** How does your IA department measures its performance?

Although 89% of organisations stated that they are compliant with the standards of the Institute of Internal auditors (Figure 25), only 8% already conducted an external quality analysis, while only 6% plans it for 2010. This is a procedure that should be conducted at least once every five years by a qualified independent reviewer from outside the organization in accordance with Standard 1312.

**Figure 30:** Did you perform an external assessment?
Authors
About PricewaterhouseCoopers

More than 163,000 people work in a network spread across 151 countries, sharing points of view, experiences and solutions in order to offer innovative perspectives and advice tailored specifically to each set of problems.

In Croatia, PwC has over 100 auditors, consultants and other staff. We employ over 25 Croatian and internationally certified chartered accountants and staff with other professional certifications, with more than 15 years of experience in audit. PwC’s service offerings have been organised into three lines of service - Audit and Assurance, Tax and Regulatory, and Advisory, each staffed with highly qualified and experienced professionals. Our client base includes some of the largest Croatian and multinational companies in Croatia. Our close interaction with economic and state bodies allows us to keep up with the fast changing environment in which businesses have to work in Croatia.

PricewaterhouseCoopers Internal Audit Services helps companies improve the value and performance of the Internal Audit function by providing solutions tailored to client situations and needs. Whether it is providing our client with outsourcing/co-sourcing, Internal Audit transformation or Internal Audit start-up assistance, we bring deep knowledge of Internal Audit along with subject matter specialists who know our client’s industry and its technical risk areas. Services we provide include: outsourcing and co-sourcing, Internal Audit transformation, Quality Assurance Review, Internal Audit training and start-up Internal Audit services.

For further information, consult our website at www.pwc.com/hr or contact:

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About the Croatian Institute of Internal Auditors

HIIR is a member of the Institute of Internal Auditors and the European Confederation of the Institutes of Internal Auditors. The main function of the Institute is to promote and develop the professional practice of the career of Internal Audit, with the objective to become a leading authority in issues concerning the development of Internal Audit, internal control systems and a reputable authority in the field of administration and regulation of companies in Croatia.

The activity objective is to be educational, normative, and methodical, and to provide consultative activity in the field of internal audit, administration, control and regulation of companies and organizations.

For further information, consult our website at www.hiir.hr or contact:

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