Essay Topic:

Modern Internal Auditing: Accounting-Related or Management-Orientated?

1. Describe the development of internal auditing from accounting assurance only to value adding for management.
2. Explain how internal audit has become a key advisor to management on aspects beyond finance and accounting.
3. Discuss the changing role of internal audit to consulting.
4. Address the balance and ability to perform both assurance and consulting on nonfinancial aspects.

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Internal Audit Foundation

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About the Author

Elizabeth White is currently a master of accounting student at Kennesaw State University, specializing in audit and advisory. During her undergraduate education, she was the officer of reporting in the Beta Alpha Psi Iota Tau chapter and completed two internships at Carr, Riggs, and Ingram. While completing her master’s degree, The Institute of Internal Auditors (IIA) sponsored her position as the graduate research assistant for the University’s Internal Audit Center director.
Introduction

The role of internal auditing has evolved and grown as the business world has changed. In the infancy of internal audit functions, management relied on the department to provide assurance on the accuracy of the financial statements. The reliance on the department grew beyond finance. Internal auditors became “trusted advisors” to add value to their organizations and assure management on matters beyond financial reporting, like compliance and operations. Then, the profession grew to provide consulting services. The demand for internal audit services created blended engagements, which allow for both consulting and assurance. This manuscript provides a high-level review of how internal auditors have evolved to become a key value-adding component of business.
Providing Assurance

Internal audit functions provide assurance services to ensure the organization is on the correct path to achieve its business objectives and correctly mitigate risks (Anderson, et al., 2017). A part of the process includes testing the business practices for strong internal controls. An internal control is “a process, effected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting, and compliance” (COSO, 2013). Internal audit functions create value for organizations “by providing opportunities to achieve organizational objectives, identifying operational improvement, and/or reducing risk exposure through both assurance and consulting services” (Anderson, et al., 2017). Internal auditors provide assurance on company financials, operations, and compliance.

Financial

In the early 1900s, internal audit functions were created primarily to check accuracy or for errors and fraud in financial transactions (Parker and Lynn, 2017). Internal auditors did this to provide assurance to management that the financial statements were reliable. During that time, financial reliability was at the forefront of management’s concerns. In 1941, The IIA was formed. The IIA published the Statement of Responsibilities of Internal Auditing in 1947 to attempt to define the profession (Brooks and Hohmann, 2016). Interestingly, the most controversial topic during the development of the Statement of Responsibilities of Internal Auditing was “whether the internal auditor should be concerned with areas outside the financial arena;” the authors compromised to include that the profession would mainly deal with financial and accounting issues, but it could also properly handle operating matters (Brooks and Hohmann, 2016). As time passed and corporate regulations increased, the roles of internal auditors started to evolve into more than just a hindsight “look into what had gone wrong and how we might improve” on financial reliability (Brooks and Hohmann, 2016). The internal audit function began to shift from being just an internal check for management to adding an “objective appraisal of management functions, clerical routines, and operating activities” (Parker and Lynn, 2017). Today, financial assurance does not act as a simple review of the accounting as it did when
it was first established. Internal auditors’ role in financial reporting includes accuracy of the financial statements and the testing of the controls over financial reporting.

**Operational**

Internal audit provides management assurance on operations. During an operational audit, the internal auditor tests the business processes to ensure they are in line with management objectives and policies. Operational audits “also serve to safeguard resources against loss due to waste, abuse, mismanagement, errors and fraud” (Gab et al., 2018). An example of loss could be found in the initial internal audit of a manufacturing company’s inventory process. An objective internal auditor would observe and document the process to determine whether the established procedures are being followed. In this example, assume that a step is being skipped, which, unknowingly to the operator, is increasing the product scrap rate by five percent. In this situation, the internal auditor would document the findings and report to management. It would then be management’s responsibility to act on the internal audit report.

**Compliance**

After the Great Depression, laws and regulations over business increased, which “created new demands for management control to ensure compliance and protect against regulatory action” (Parker and Lynn, 2017). Internal auditors are a key asset to management in determining whether the company is operating within regulations. Compliance audit procedures are similar to operational audits. An internal auditor will use interviews, observations, and information from policy documents and regulations to determine compliance (Weske, et al., 2018). Internal auditors add value to the organization by staying abreast on new and updated laws and regulations.

In May 2018, the European Union’s (EU’s) General Data Protection Regulation (GDPR) presented internal auditors with a new data protection regulation (Hertzberg, 2018). GDPR applies to all organizations that do business with E.U. citizens to provide the citizens with increased control over their personal data (Hertzberg, 2018). Businesses will rely on internal audit to mitigate risks related to GDPR to avoid the 20 million euro or four percent...
of annual worldwide turnover penalty for noncompliance (Hertzberg, 2018). Internal auditors should approach this new regulation like they would with any other compliance issue. Internal audit functions identify opportunities to improve controls, raise awareness of the risks, and assure compliance.

**Management's Key Advisor**

An internal auditor objectively and independently provides consulting and assurance services to improve and add value to organizations by helping them achieve their objectives (Anderson, et al., 2017). In order to become a key advisor to management, internal auditors must embody the attributes of trusted advisors. Richard Chambers, president and CEO of The IIA, wrote the book *Trusted Advisors* specifically detailing nine attributes of outstanding internal auditors. Internal auditors working as trusted advisors to management are better equipped to drive change in the business and help implement best practices.

**Trusted Advisor**

The first step to becoming a key advisor of management is earning management's trust. The attributes of internal auditors working as trusted advisors are broken out into three main categories: personal, relational, and professional (Chambers, 2017). It is important to note these leadership qualities are critical to the success of becoming a leader.

![Figure 1: Attributes of Outstanding Trusted Advisors (Chambers, 2017)](image-url)
**Personal Attributes**
The personal attributes of internal auditors are the foundation to becoming trusted advisors. Perhaps the most important personal attribute is ethical resilience. Internal auditors must “adhere to the highest ethical code, and never yield to pressures to bend the rules” (Chambers, 2017). Occasionally, an internal auditor may experience pushback during an engagement. Management relies on internal auditors to be steadfast in their ethics, and if one internal auditor’s ethics fail, it will cause management’s trust in individuals and others on the team to diminish (Chambers, 2017). It is important to the profession that internal auditors always have the courage to do the right thing.

**Relational Attributes**
Internal auditors’ relationship skills are a strong contributor to being successful in the profession (Chambers, 2017). Without the skill to effectively communicate to management, internal audit function results and ideas are at risk to be passed over when it comes to implementation. Dynamic communication skills are the drawbridge to castles of insightful relationships. Outstanding trusted advisors differentiate themselves by building strong relationships with clients and other stakeholders (Chambers, 2017). As a result, these trusted advisors are more likely to be sought out for future assurance from clients that have good relationships with them.

**Professional Attributes**
Internal auditors’ professional attributes are the final pieces to solidifying their positions as trusted advisors. Internal auditors must think critically and have technical expertise. Management trusts internal auditors to make decisions “based on an ability to analyze the problem, identify and evaluate potential solutions, consider the environment, and only then proceed” (Chambers, 2017). During the critical thinking process, it is important for internal auditors not to rush to a decision, nor should the process be drawn out. Answers internal auditors provide can have an impact on the business. For that reason, they must also possess proper business acumen (Chambers, 2017). Internal auditors offer assurance on multiple facets of business. Therefore, they should “have the ability to see across the many
areas of expertise within a company, such as finance, research and development, marketing, and IT; understand how decisions affect each of these areas; and work toward coordinating efforts to ensure shared success” (Chambers, 2017).

Overall, the core foundation of these nine attributes allow internal auditors to achieve excellence in the profession and advise management on aspects beyond finance and accounting as trusted advisors.

**Consulting**

**Assurance vs Consulting**

In 1947, The IIA defined internal auditing in the Statement of Responsibilities of Internal Auditing as “the independent appraisal activity within an organization for the review of the accounting, financial, and other operations as a basis for protective and constructive service to management” (Parker and Lynn, 2017). At the time, internal auditors were focused on assurance only. Today, The IIA defines internal auditing as “independent, objective assurance and consulting activity designed to add value and improve an organization's operations” (IPPF, 2017). Modern internal audit functions provide two types of services: assurance and consulting (Head, et al., 2010). Consulting services are intended to improve business processes and management without the internal audit function assuming management responsibility (Anderson, et al., 2017).

Assurance and consulting services differ in “the number of parties involved in the engagement, the application of The IIA’s *International Standards for the Professional Practice of Internal Auditing* to both types of services, the purpose of the engagement, and communication of engagement results” (Anderson, et al., 2017). Consulting services are less complex structurally in that there are only two parties involved. On the other hand, assurance services involve three parties, and as a result, have more stringent implementation standards to follow and comply with during engagements (Anderson, et al., 2017). Prior to the change in the definition of internal auditing, engagements would have been to provide assurance based on audit evidence (Head, et al., 2010). After the change,
engagements can also be focused on providing objective advice, training services, or facilitation (Head, et al., 2010). Consulting services contrast to assurance in that the service offers foresight to management to strategically anticipate future challenges and opportunities (Brooks and Hohmann, 2016). Communications to the receptive parties on assurance and consulting engagements differ as well. Assurance engagement communications are fairly standardized (Anderson, et al., 2017). On the other hand, consulting engagement communications vary from engagement to engagement depending on the type of consulting activity internal audit is reporting on (Anderson, et al., 2017). The addition of consulting services to the role of internal auditors is a testament to the growth of the profession and the value it has in business.

**Finding Balance**

How do internal auditors balance and perform both assurance and consulting services? Many internal audit functions do not have an unlimited amount of resources to fulfill all assurance and consulting engagements. However, stakeholders are of a “general consensus that advisory work should not detract from or diminish the quality of assurance work” (Rachmiel, 2017). The balancing act often falls to the highest-ranking internal auditor at the company. Chief audit executives (CAEs) are primarily responsible for the allocation of internal audit resources to assurance and consulting (Rachmiel, 2017). Surprisingly, there is question as to whether the internal audit function needs to provide assurance; a few internal audit functions have “shifted their activities to the point where they are doing essentially no traditional audit work” (The IIA, 2012). CAEs, embodying the qualities of trusted advisors, are assigned the difficult task of determining the allocation of the resources. When weighing the resources, CAEs often consult with frontline management, executives, and audit committee members to create a balanced scorecard decision.

Shortly after consulting was added to the definition of internal auditing, a research survey was distributed to 11 internal audit directors in Ohio to see if the addition of consulting was reflective of day-to-day activities (Nagy and Cenker, 2019). The researchers found that
the majority of the internal audit directors agree with the change, but also felt that the traditional role, to assure, should not be abandoned (Nagy and Cenker, 2019).

Blended Engagements

One way internal auditors can balance assurance and consulting is to blend the services. Although the services are different, “the two can be blended together in a single engagement without jeopardizing audit effectiveness or objectivity” (Head, et al., 2010). In the aforementioned research survey, many of the directors responded that “their respective internal auditing departments have been focusing on value-added activities for years, and the ‘the definition has finally caught up with practice’” (Nagy and Cenker, 2019). It is likely that the directors were leading their teams through blended engagements. Blended engagements are used by internal audit functions to “gain efficiencies in the overall audit process without sacrificing effectiveness” (Head, et al., 2010). If there are not enough resources, the CAEs could assign blended engagements. Examples of blended engagements describing the assurance components and the consulting components are in appendix 1.

Caution Ahead

Internal auditors advise management in enterprise risk management (ERM). ERM is “the culture, capabilities, and practices, integrated with strategy-setting, that organizations rely on to manage risk in creating, preserving, and realizing value.” (Anderson, et al., 2017). Providing management with this consulting service can create a blurry line for internal audit independence. Internal auditors have worked with management to assist on several ERM implementations; however, “there are concerns about the potential compromising of IA’s objectivity and independence when the [internal auditor] assumes responsibility for ERM implementation” (Viscelli, et al., 2016). There is a range of roles internal audit can provide in regard to ERM, which is depicted in appendix 2. On one end of the spectrum, internal auditors can fulfill roles to ERM without risk to independence. On the other side, management responsibilities related to ERM are listed and internal auditors should not perform those tasks. There is debate on the depth the IIA guidelines allow in regard to ERM; however, the internal audit community agrees that internal audit functions should
not own risk because that would threaten their objectivity and independence in assessing risk (Viscelli, et al., 2016).

**Conclusion**

From 1941 to today, the profession of internal auditing has experienced tremendous growth. Corporate management realized internal audit functions were capable of more than solely providing assurance on the business financials. Internal auditors could evaluate an organization's compliance with laws and regulations. Additionally, internal auditors could assure management on the business operations. As the role of the internal audit function developed, management began to trust them as key advisors. Then, consulting services became a service the internal audit function could provide. With this new role, internal auditors need to remain astute in their position of objectivity and independence. The profession of internal auditing has evolved and continues to grow as a value-adding business function.
## Appendix 1

**Illustrative Blended Engagements**

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<th>Example Engagements</th>
<th>Example Assurance Components</th>
<th>Example Consulting Components</th>
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| **Due Diligence:** Internal auditing provides assurance and consulting services in support of management’s evaluation of an acquisition candidate. | - Assess the adequacy of key controls in certain areas.  
- Assess the adequacy of documentation supporting management’s control evaluations (e.g., Sarbanes-Oxley Section 404).  
- Assess the rigor of the risk management program in place.  
- Determine whether other functions involved in the due diligence process have fulfilled their assigned responsibilities adequately and can support their conclusions. | - Design an evaluation checklist that can be used by other functions involved in evaluating the acquisition candidate.  
- Facilitate management discussions regarding potential acquisition candidate evaluation criteria. |

| System Development: Internal auditing provides assurance and consulting services during and after a significant system conversion project. | - Determine whether the organization’s prescribed system development process is followed throughout the project.  
- Assess whether user acceptance testing was sufficient and whether the testing results support management’s decision to move forward with the project.  
- Evaluate whether the new system, as implemented, achieves system objectives and meets users’ requirements. | - Facilitate the process of defining system user requirements.  
- Advise on system development best practices.  
- Train users on their system development roles and responsibilities. |

| Process Reengineering: Internal auditing provides assurance and consulting services during and after a process reengineering project. | - Assess whether the process reengineering team adhered to management’s prescribed reengineering policies and procedures.  
- Determine whether controls in the reengineered process are designed adequately. | - Advise on how to conduct an effective and efficient process reengineering project.  
- Train key individuals involved in the project on steps to perform, analysis techniques, and documentation requirements.  
- Advise on specific procedures that will enhance the design of the process. |

| Risk Management: Internal auditing provides assurance and consulting services in support of the organization’s risk management program. | - Assess the adequacy of the existing risk management program against best practices.  
- Evaluate the completeness of the enterprise risk universe and reasonableness of the risk ratings.  
- Assess whether the information provided by management to the board is accurate, relevant, and comprehensive. | - Facilitate the annual risk assessment process.  
- Advise on different strategies that may be used to manage key risks.  
- Train risk owners on their risk management responsibilities.  
- Advise management on the steps necessary to initiate an enterprisewide risk management program. |

Source: “Blended Engagements”  
(Head, et al., 2010)
Appendix 2

INTERNAL AUDIT ROLE IN ENTERPRISE RISK MANAGEMENT

References
Donna B. Brooks and Martha Hohmann, *Celebrating Our Past ... Inspiring the Future: 75 Years of Advancing the Internal Audit Profession* (Lake Mary, FL: Internal Audit Foundation, 2016).
“About the IIA,” (The IIA, 2019). [https://global.theiia.org/about/about-internal-auditing/Pages/About-Internal-Auditing.aspx](https://global.theiia.org/about/about-internal-auditing/Pages/About-Internal-Auditing.aspx) (accessed February 21, 2019).

