Internal Auditing and Its Stakeholders:

Understanding Perceptions, Achieving Potential

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Essay Topic:
What are some of the key ways internal auditors can address the specific expectations of chief stakeholders without impacting the auditor’s independence and objectivity?

What unique strategies and tactics can be implemented to continuously meet the needs of key stakeholders?

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I am grateful for the opportunity to discuss the internal auditing profession with these individuals. Their insights have contributed to both this paper and my professional growth.
About the Author

Jonathan E. Bayhi was born and raised in Baton Rouge, Louisiana. As an accounting graduate student in the LSUCIA Program, he served as a class president and received the Roger L. McDaniel Service Award.

Jonathan has passed both the Certified Internal Auditor (CIA) and Certified Financial Services Auditor (CFSA) exams and will obtain certification upon completion of necessary experience requirements. During the summer of 2011, he interned with Protiviti in Houston, Texas. Later this year, Jonathan will join Protiviti full-time with a Bachelor and Master of Science (BS/MS) in Accounting and a specialization in Internal Auditing.
Executive Summary

The definition of internal auditing states that the profession is “designed to add value” to an organization’s operations.\(^1\) While the cost of many products or services can be reasonably calculated, value is determined by an end user’s perception of the utility provided by a product or service. Similarly, the value of the internal auditing profession is directly correlated with the perceptions of its key stakeholders.

Currently funded by the William G. Bishop III, CIA, Memorial Fund, the Common Body of Knowledge (CBOK) is a culmination of research projects dating back to 1972 commissioned by The Institute of Internal Auditors Research Foundation (The IIARF).\(^2\) The 2010-2011 CBOK study elicited responses from over 13,000 participants, giving insight into the practice and perceptions of internal auditing worldwide. This paper leverages the findings of the 2010-2011 CBOK study as well as insight from internal audit professionals to examine opportunities for internal auditors to address the expectations and perceptions of key stakeholders while preserving independence and objectivity.

**Part I** of this paper identifies internal auditing’s key stakeholders: the board of directors, senior management, and operational management. To enhance the perceived contributions of the internal audit activity, chief audit executives (CAEs) and their audit staff must understand and prioritize the needs, expectations, and perceptions of these key stakeholders. As the audit activity works closely with its key stakeholders, internal auditors must identify and communicate conditions that could impair objectivity or independence.

**Part II** of this paper attempts to reconcile stakeholders’ perceptions and internal auditing’s potential. Additionally, Part II identifies opportunities to promote the value-add potential of the internal audit activity within the organization.

**Part III** examines the components that leading internal audit departments are including in their internal audit strategy. A quality internal audit strategy presents an excellent opportunity for CAEs to align the activities of the audit function with the needs of key stakeholders.

**Part IV** addresses risk-based audit planning. To continuously meet and exceed the expectations of stakeholders, internal auditors will need to develop and execute a risk-based audit plan that optimizes internal audit resources and addresses the organization’s significant risks.

**Part V** leverages the findings of the CBOK study to identify current metrics commonly used to measure internal audit performance. This section also addresses performance metrics that are expected to gain use over the coming years. Finally, the paper’s conclusion addresses the Value Proposition of internal auditing moving into the future. Internal auditors must anticipate change to emerge as trusted advisors as management and board directors face critical decisions in the midst of uncertainty.

Researching and preparing this paper has certainly given me greater insight into the profession of internal auditing. I hope it provides a similar benefit to other professionals.

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\(^1\) (IPPF) Definition of Internal Auditing.

\(^2\) “CBOK Study – A History,” Institute of Internal Auditors, Accessed 22 February 2012.
Introduction

Even after the United States’ (US) 2007-2008 Market Meltdown resulted in collapse for several prominent institutions, the news media continues to air similar stories of failure:

- In September of 2011, solar panel producer, Solyndra, filed for bankruptcy just two years after receiving a $535 million loan from US taxpayers. During a US House Energy and Commerce subcommittee hearing, one congressman chastised a government energy director responsible for oversight of the Solyndra loan by asking, “What do you do for a living? If you don’t know what’s happening and everyone else is to blame, what do we go back and tell our constituents?”

- Also in September of 2011, Swiss banking giant, UBS, announced it had uncovered approximately $2 billion in losses resulting from “unauthorized trading” by an employee. The CEO of UBS resigned just days after announcing the losses, with several other executives and board directors stepping down thereafter. In February of 2012, self-regulatory organizations announced they were launching formal enforcement investigations to “assess and rule upon the adequacy of the controls that were in place to prevent and detect unauthorized trading” as well as determine UBS’s compliance with various regulations.

- In October of 2011, MF Global Holdings, “one of the world’s leading brokers in markets for commodities and listed derivatives,” declared bankruptcy after taking excessive one-sided bets on European sovereign debt. To make matters worse, it was discovered that an estimated $1.6 billion in customer accounts were not reconciled. In December of 2011, the CEO of MF Global testified before the US House of Representatives saying, “I simply do not know where the money is, or why the accounts have not been reconciled to date.” At the time this paper was written, MF Global represents the eighth-largest corporate bankruptcy in US history.

While each storyline may be different, a common theme emerges – ineffective governance, poor risk management, and/or failed internal control. Board directors and management are left facing the outrage of shareholders, employees, regulatory agencies, and the general public. Rather than focus on the details of these cases, this paper will identify how internal auditors can help their key stakeholders – management and the board of directors – avoid similar failure while promoting organizational success. The objective of this paper is to identify ways internal auditors can remain independent and objective while aggressively addressing the needs, expectations, and perceptions of their stakeholders.

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10 Corzine, Jon. Statement to the House, Committee on Agriculture. The Unreconciled Accounts, Hearing, 8 December 2011.
Part I: Contributions of the Internal Audit Activity

Internal auditors add value for key stakeholders by providing independent, objective assurance and consulting services. The internal audit activity promotes organizational objectives through a “systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.” The Institute of Internal Auditors (The IIA) has further defined the Value Proposition of internal auditing as providing "assurance, insight, and objectivity" to stakeholders.

Internal Audit Stakeholders
While internal auditing has many indirect stakeholders, CAEs can promote the Value Proposition by addressing the needs and expectations of three primary groups: the board of directors, senior management, and operational management.

The Board of Directors/Audit Committee:  
Boards are comprised of senior executives (both internal and external to the organization), academics, or other successful professionals who serve on an organization’s board in addition to other responsibilities. As a result, some directors may be inherently insulated from the organization’s underlying operations. Boards meet throughout the year to assess management’s performance and oversee the organization’s direction, often relying on reports and presentations prepared by management. Leading boards demand reliable and transparent information as well as objective analysis that effectively communicate the organization’s critical issues, key risks, and strategic performance. Internal auditors are positioned to play a vital role in providing the board of directors – usually through an audit committee – with the objective assurance and insight needed to promote accountability and sustainability over an organization’s governance, risk management, and internal control processes.

Senior Management:
The board of directors delegates the organization’s day-to-day performance to senior management, who is responsible for strategic planning and oversight. Additionally, senior management should design and maintain systems and processes that help the organization achieve its objectives. The internal audit activity can assist senior management by evaluating these processes and promoting their continuous improvement. The enterprise-wide perspective of the internal audit function positions the CAE as a valuable advisor to senior management in understanding, communicating, and improving the efficiency and effectiveness of organizational performance.

Operational Management/Process Owners:
Operational management is arguably the primary benefactor of the audit process. These individuals tend to have the closest interaction with the activities that internal auditors seek to evaluate and improve. Operational managers are often responsible for a specific process, function, or business unit

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12 (IPPF) Definition of Internal Auditing.
13 Ibid.
within the organization. Understanding the activities, needs, and perceptions of front-line personnel becomes essential as internal auditors promote the organization’s objectives.

Rob Walls, Chief Audit Executive at Cajun Industries, stresses the importance of listening to front-line personnel. He says, “I like to find a ‘good complainer’, and listen to what he or she has to say. The ‘good complainers’ are often individuals who take pride in their work, can provide significant insight into their sphere of operations, and are willing to voice issues that are affecting their work. These ‘complainers’ typically distinguish themselves from the malcontents by offering viable solutions to improve the business process. We try to seek these people out because they can help us obtain knowledge in areas under review, enabling us to ramp up our efforts very quickly.”

Serving Many Stakeholders
CAEs must balance the different needs and expectations of multiple stakeholder groups. For example, the audit committee and senior management might be especially concerned with assurance over financial reporting and regulatory compliance. Operational management, on the other hand, may value insight toward process improvements. Given the audit function’s limited resources, it is imperative that CAEs understand and prioritize the needs of their key stakeholders. CAEs can then develop an internal audit strategy and risk-based audit plan that align stakeholders’ expectations and the value-add potential of the internal audit activity.

Jim DeLoach, Managing Director at Protiviti, further adds, “If the internal audit activity can take a lead role in helping the rest of the organization become more risk aware, initiate improvements in risk management across the organization through the execution of the audit plan, and identify emerging risks, it will add value that the audit committee and senior management will recognize.”

Independence and Objectivity
Internal auditing, and the value it provides to stakeholders, is rooted in independence and objectivity. Audit committees rely on internal auditors’ objective assurance necessary for the board to fulfill its fiduciary duties. Similarly, senior managers value assurance and consulting engagements that communicate and potentially improve the implementation of management initiatives. The breadth of audit engagements gives CAEs significant insight regarding the organization’s risk profile, emerging risks, appropriateness of risk responses, and underlying strategic assumptions. Accordingly, CAEs are uniquely positioned to provide insight as stakeholders face critical decisions. As internal auditors become trusted business partners for their stakeholders, they must recognize conditions that threaten independence or objectivity.

Independence results from the positioning of the internal audit activity within the organization. The dual reporting relationship – functionally to the board and administratively to senior management – attempts to remove conditions that might threaten internal auditors’ ability to carry out their responsibilities in an unbiased manner. Objectivity results from an internal auditor’s mindset. It is a mental attitude that allows internal auditors to believe in their work without compromising audit quality. The CAE must continually assess independence and objectivity and report to the audit

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10 (IPPF) Attribute Standard 1100 – Independence and Objectivity.
committee or an appropriate party any issues that could impact the audit activity’s responsibility to senior management and the board.\textsuperscript{17}

In 1999, The IIA’s Guidance Task Force published \textit{A Vision for the Future} which recognized that \textit{independence} and \textit{objectivity} were “more or less synonymous” in common usage. The Task Force’s report cited the need to differentiate between these terms in the definition of internal auditing, leading to “a conceptually superior framework for standards-setting.”\textsuperscript{18}

\textbf{Brian Holland}, Audit and Advisory Services Director at Pitney Bowes, stresses that the need for independence and objectivity does not preclude internal auditors from adding value. He states, “As a business advisor, being objective means the advice I provide the business or process owner is candid and free of bias. Management should expect more from the audit function than simply a laundry list of what’s broken and cursory recommendations on corrective action.” He adds, “Provided it’s clear that the final decision on all aspects of corrective action rests with management, there should be no conflict with respect to independence. It’s ultimately management’s commitment as to what will be done and in what time frame, and the final audit report should be absolutely unambiguous on this point.”

As internal auditors seek to enhance their contributions to the organization, they must exercise professional judgment to identify and communicate any potential impairment and its effect on audit quality. Professional literature such as the IPPF provides further guidance concerning impairment and appropriate safeguards surrounding independence and objectivity.

\begin{itemize}
\item \textsuperscript{17} (IPPF) Attribute Standard 1130 – Impairment to Independence or Objectivity.
\end{itemize}
Part II: Perception versus Potential

While the CBOK component *Measuring Internal Auditing’s Value* reflects that 92 percent of stakeholders agree their internal audit activity adds value, there is further room for improvement.\(^{19}\)\(^{20}\) Part II of this paper explores how internal auditors can understand, address, and enhance the perceived value of their contributions.

**Reconciling Internal Auditing and Stakeholder Expectations**

As CAEs begin to assess their perceived contribution to the organization, it may be useful to perform the gap analysis shown in Figure 2-1 below.

![Figure 2-1: Adding Value – Perception to Potential](image)

The left side of Figure 2-1 depicts the difference between stakeholders’ perceptions of internal audit contributions and the expectations of stakeholders. This situation often arises because senior management and the audit committee may have differing expectations for the internal audit activity. Thus, as internal auditors attempt to satisfy two different sets of expectations, one group (or possibly both groups) of stakeholders may feel that the audit function could add more value. For example, the audit committee may expect internal audit resources to focus on preserving value by providing assurance over internal control and financial reporting. In contrast, senior management may expect consulting engagements that can enhance the value of the organization. CAEs must collaborate with key stakeholders and seek a mutual understanding of the internal audit activity’s role within the organization. Otherwise, the perceived contributions of the internal audit function may be limited by the differing expectations of stakeholder groups.

The right side of Figure 2-1 displays the difference between stakeholder expectations and the potential capabilities of the internal audit activity. This focuses on the upside of internal auditing. Many stakeholders may not fully realize the value their internal audit function is capable of adding to the organization.

\(^{19}\) 44 percent *strongly agree* and 48 percent *agree.*

organization. Internal auditors that have been focused on regulatory compliance or financial reporting processes may not be perceived by stakeholders as possessing the insight to improve governance and risk management processes, much less the ability to enhance decisions around organizational strategy. The nature of internal audit engagements is predominantly dictated by factors such as the organization’s size, structure, and risk maturity; the organization’s industry and regulatory landscape; and the entrenchment of organizational expectations for the internal audit activity. If internal auditors are not convinced their insight is being fully leveraged, then CAEs must communicate to stakeholders the capabilities of their internal audit function. As organizations seek to harness the true potential of the audit activity, audit staff should remain cognizant of conditions that could potentially impair independence or objectivity. Any impairment, whether in fact or appearance, should be disclosed to appropriate parties.21

Promoting the Value Proposition
In the CBOK component, Core Competencies for the Internal Auditor, CAEs identified “promoting the value of the internal audit function” as the most important incremental competency for their position.22 The ability to promote the internal audit activity can significantly impact the resources allocated toward the function’s efforts. Additionally, the perception of the audit function is often correlated with the promotion of the audit function. Key ways that CAEs can promote the internal audit activity are listed below.

Organizational Brochures, Newsletters, and Intracompany Websites:
These publications can address recent or pending external events – legislation, new technologies, or major industry changes – and their implications for the organization. Addressing issues that concern stakeholders can foster the trusted business partnership internal auditors seek to achieve. The tone of these publications should be centered on the organization and internal audit stakeholders, yet indirectly promote the capabilities of the audit activity.

Facilitated Workshops:
Given the audit activity’s holistic view of the organization’s risk profile and control processes, internal auditors can be obvious candidates for facilitating control self-assessments or other various training. Facilitating workshops can provide internal auditors visibility within the organization and uncover critical issues that concern stakeholders. As a result, CAEs can more effectively plan audits perceived to be relevant. Successfully planned and executed workshops addressing participants’ needs can enhance internal auditors’ credibility, as well as promote the value-add potential of the internal audit activity.23

Quality Deliverables:
Delivering quality audits might seem obvious, however it cannot be stressed nearly enough. To adapt the popular quote of Warren Buffett, CEO of Berkshire Hathaway, “It can take one-hundred good audits to build a reputation, but only a single bad audit to ruin it.”24 Every engagement represents an

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21 (IPPF) Attribute Standard 1130 – Impairment to Independence or Objectivity.
opportunity to promote the audit function’s abilities. A reputation of quality audits that consistently exceed stakeholders’ expectations and add value for the organization can be far more promotional than any flyer or presentation. Thus, delivering value is fundamental to promoting value.

Joel Kramer, Vice President-Internal Audit Division at the MIS Training Institute, emphasizes that business acumen is critical in promoting the internal audit activity. He states, “To be effective sales people and marketers, the (internal audit) department must first really understand the business – what the organization does, its significant and emerging risks, its business plans and goals, and how it accomplishes them.” Kramer says that internal auditors must understand the needs of key stakeholders, and then effectively communicate how the audit function can satisfy those needs. He adds, “Talking up internal audit without having this knowledge and plans to address needs is a big mistake because the work likely will not meet the promise, thus doing harm to the department’s credibility.”

Jessica Rockenbaugh, Internal Audit Manager at Cajun Industries, adds, “As part of our annual audit planning, we conduct ‘Stakeholder Expectation Interviews’ with audit committee members, executives, company presidents, and other managers within our company. These meetings help our audit function gain an understanding of management’s strategy and goals, allowing us to identify additional risks within the company and align our audit focus based on those risks. The interviews also provide us with an opportunity to meet with key stakeholders and communicate how our internal audit function can provide additional support and add value to their area of the organization.”

CAEs can promote the Value Proposition by visibly marketing the internal audit activity as more than just an audit function. Internal auditors should foster positive relationships with stakeholders and promote a trusted partnership in the areas of governance, risk management, and control.

Part III: Internal Audit Strategy: Aligning with the Organization

In the IIARF research paper, Insight: Delivering Value to Stakeholders, nearly 90 percent of senior executives and CAEs agree that the internal audit activity should provide insight, but only 56 percent of executives indicate that their audit function actually provides insight. Interestingly, nearly 81 percent of CAEs indicate that their internal audit activity provides insight to the organization. This gap, as seen in Figure 3-1, represents an opportunity for CAEs to develop an internal audit strategy that reflects the needs and expectations of key stakeholders. A quality strategy is critical to strengthening the Value Proposition and perceived contributions of the internal audit activity.

Figure 3-1: Internal Audit Insight – Perceived or Provided?

Internal Audit Strategic Vision

The CBOK component, Imperatives for Change, reflects that leading internal audit departments have a strategic vision outlining the mission and objectives of the internal audit activity moving into the future. The vision should be tailored to the mission and objectives of the overall organization, as well as the organization’s industry, regulatory environment, and risk maturity. The internal audit strategic vision should be supported by four governance documents: the internal audit charter, mission statement, vision statement, and strategic plan.

Internal Audit Charter:

CAEs must collaborate with management and the audit committee to develop a quality internal audit charter. As required by the Standards, the internal audit charter should define the “purpose, authority,

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29 Ibid.
and responsibility” of the internal audit activity and outline the nature of assurance and consulting engagements.\textsuperscript{30} A quality charter extends beyond formal legalese to reflect actual activities of the internal audit function and should implicitly include the expectations of key stakeholders. Additionally, the charter serves to establish the functional and administrative reporting lines of the internal audit activity – promoting independence and objectivity. \textit{Attribute Standard 1000 – Purpose, Authority, and Responsibility} requires the charter be periodically reviewed for appropriateness by the CAE and approved by senior management and the board.\textsuperscript{31} The charter and its review are opportunities for the CAE, senior management, and the audit committee to reach a common understanding of how the internal audit activity will function and add value for the organization while preserving independence and objectivity.

\textbf{Internal Audit Mission and Vision Statements:}

The internal audit \textit{mission statement} is described as a “high-level narrative” that reflects near-term audit engagements and stakeholder needs. In contrast, the internal audit \textit{vision statement} reflects where an internal audit activity aspires to be. The vision statement helps CAEs anticipate the future expectations of senior management and the board of directors.\textsuperscript{32} Formal mission and vision statements are critical components in positioning the audit function to continuously add value to the organization.

\textbf{Internal Audit Strategic Plan:}

The internal audit strategic plan should complement the vision statement. It should align with the organization’s strategy to help the CAE anticipate future resources required to meet stakeholder needs. The strategic plan should be forward-looking – perhaps three to five years – and address the organization’s current and anticipated risks and vulnerabilities.\textsuperscript{33} The plan should include input from senior management, the audit committee, and internal audit staff to recognize their concerns and encourage buy-in from these constituents.

Only 51 percent of the 2010 Global Internal Audit Survey respondents report having an internal audit strategy in place, representing an opportunity for internal auditors to align their efforts with the needs of key stakeholders.\textsuperscript{34} Ideally, each of the documents listed above should be reviewed and approved at least periodically to promote continuous alignment with the organization’s ever-changing risks and objectives.

\textsuperscript{30}(IPPF) \textit{Attribute Standard 1000 – Purpose, Authority, and Responsibility.}

\textsuperscript{31}Ibid.

\textsuperscript{32}Anderson, Richard and J. Christopher Svare, pp 13-14.


\textsuperscript{34}Anderson, Richard and J. Christopher Svare, page 13.
Part IV: Risk-Based Audit Planning

As previously mentioned, the board of directors, senior management, and operational management often have different perceptions and expectations of the internal audit activity. CAEs must collaborate with each group of stakeholders to reach a common agreement on the audit activity’s role within the organization. CAEs can then develop and execute a risk-based audit plan that is more likely to be perceived by stakeholders as adding value.

Developing the Risk-Based Audit Plan
The CBOK component, *Imperatives for Change*, indicates only 72 percent of respondents perform an internal audit risk assessment as part of audit planning. CAEs can strengthen their risk-based planning process by incorporating an independent risk assessment and gathering input from key stakeholders, further enhancing buy-in and the perceived value of the internal audit activity.

Risk-based audit planning should be viewed as a dynamic exercise. For audit engagements to remain relevant and continue to add value, the audit plan must be responsive to changes within the organization and its environment. A certain amount of flexibility within the annual audit plan can allow CAEs to address sudden, high-impact issues that may inevitably emerge during the organization’s operating cycle. The IIA’s *Stakeholders’ Expectations and Perceptions Survey* suggests that CAEs may also need to reallocate resources from lower-risk areas to be more responsive to emerging risks that threaten the organization’s objectives.

**Jim DeLoach**, Managing Director at Protiviti, stresses the value of risk-based audit planning. He states, “Traditional risk management practices and check-the-box approaches to satisfying board requests are proving to be inadequate as further surprises and issues continue to arise in the marketplace. Most everyone agrees that an effective risk assessment should never end with just a list of risks without formulating appropriate risk responses, yet that is exactly what happens at many companies. Accordingly, we see companies enhancing their approach to risk management. CAEs can advise senior management and the board as their companies improve the risk management process, and in effect do a better job in ‘aligning the audit plan with stakeholder expectations.’”

Executing the Risk-Based Audit Plan
In addition to developing a risk-based audit plan that addresses stakeholder needs and the organization’s significant risks, CAEs must optimize resources by executing the audit plan more effectively and efficiently.

**Leveraging Audit Tools and Technologies:**
As CAEs continue to combat limited resources, it is imperative that internal auditors harness the efficiencies associated with computer-assisted audit techniques (CAATS) and other continuous auditing tools. Over 60 percent of respondents to the CBOK study expect the use of CAATs to increase during the

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next five years.37 These audit technologies often require fewer resources than traditional audit methods and can substantially increase audit coverage, freeing internal audit resources for other value-add activities.

**Paul Pettit**, Director and National Lead for Protiviti’s *Capital Projects & Contracts* and *Quality, Environmental, Health, & Safety Practices*, uses data analytics to audit vendor invoices for many of his clients. He says, "Data analytics enables us to audit large volumes, if not the entire population, of vendor invoices from a job cost perspective. This allows us to more easily identify errors or other incorrect billings from the vendor’s job costs that can translate to cost recoveries and process improvements for our clients." Pettit further adds, "Using data analytics to find significant cost recoveries often supports our recommendations and, in most cases, quantifies the value that our services added to our client."

Additionally, internal auditors can advise management in implementing analytical tools and technologies as a detective control. For example, exception reports and trend analysis tools can help process owners identify anomalies or critical developments before organizational objectives become severely threatened. Therefore, these audit tools can also add value by improving the efficiency and effectiveness of management’s monitoring activities.

**Outsourcing, Co-sourcing, and Coordination of Efforts:**
An appropriate mix of outsourcing or co-sourcing can help CAEs execute the audit plan as well as mitigate objectivity concerns. Third-party providers may possess subject matter expertise or audit methodologies in areas where the internal audit activity is not technically proficient. Accordingly, outsourcing or co-sourcing arrangements can optimize audit resources, allowing CAEs to address stakeholder needs and smooth audit demand.

**Amanda Heintze**, Consulting Manager at Postlethwaite & Netterville, provides internal audit services for many different organizations. She states, "Many clients value our expertise. For example, financial institutions are required to perform an annual independent assessment of their IT function. Many institutions may not find it cost-beneficial to retain an IT auditor on staff year-round. They may seek our assistance because we have personnel that are highly experienced in this specific area."

Outsourcing or co-sourcing can also provide a transfer of knowledge into the organization. Additionally, sourcing work to an independent third-party can help CAEs provide assurance or consulting engagements that might otherwise impair objectivity if performed by the organization’s internal auditors.

**Heintze** further adds that engagements provided by an outside party can validate a proposed course of action. She says, "One of my clients performed an internal review of their IT function which resulted in recommendations to improve operations. Since these recommendations would require a significant expenditure of funds, the client requested that we validate the internal review. With validation by an external party, our client was able to go before management and the board with support that the proposed expenditure was the best course of action for the organization."

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37 Anderson, Richard and J. Christopher Svare, page 40.
In addition to outsourcing and co-sourcing, CAEs should consider opportunities to coordinate with other parties to avoid a duplication of efforts. If applicable, leveraging work done by the organization’s compliance department, risk management department, or external auditors may allow CAEs to allocate resources to other areas of the audit universe.

Outsourcing, co-sourcing, and coordinating efforts with other parties are opportunities to execute the audit plan more efficiently. However, CAEs and their audit staff should be reminded that Attribute Standard 1100 – Independence and Objectivity requires that “internal auditors do not subordinate their judgment on audit matters to others.”38 Once again, internal auditors must exercise professional care to ensure that audit quality, independence, and/or objectivity are not compromised.

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Part V: Measuring the Internal Audit Activity’s Value

Continuously meeting and exceeding the expectations of stakeholders is inextricably linked to measuring the perceived value of internal audit efforts. The Standards require CAEs to “develop and maintain a quality assurance and improvement program (QAIP)” for the internal audit activity. The QAIP assesses and improves the activities of the audit function and “provides assurance to various stakeholders that the internal audit activity...is perceived by those stakeholders as adding value and improving the organization’s operations.” Part V of this paper examines performance metrics typically used within QAIPs to measure the contributions of the internal audit activity.

Current Internal Audit Performance Metrics

According to the CBOK component Measuring Internal Auditing’s Value, the top methods currently used to measure internal audit performance are shown below:

Percentage of Audit Plan Completed:
The Standards require CAEs to “report periodically to senior management and the board on the internal audit activity’s...performance relative to its plan.” Monitoring the audit activity’s progress toward the audit plan can be an effective way to assess audit coverage and efficiency. However, this metric invariably relies on the quality of the underlying audit plan. CAEs must continually communicate with both the board and senior management to ensure the audit plan remains relevant to the organization’s changing objectives and related risks. Measuring progress toward an irrelevant audit plan could misrepresent the actual value contributed by the internal audit activity, and might also provide false assurance to key stakeholders. While measuring audit plan completion can be very effective, this metric should be used in combination with other performance measures.

Acceptance and Implementation of Audit Recommendations:
The number of internal audit recommendations implemented can imply the perceived value of those recommendations. CAEs must remember that strictly focusing on the “quantity” of recommendations implemented could distort the actual value contributed by the internal audit activity. One high-likelihood, high-impact recommendation could potentially contribute far greater value to the organization than several low-likelihood, low-impact recommendations. Similarly, recommendations that enhance preventive controls may prove far more valuable than recommendations that address detective controls. This metric is useful; however, it too should be used in combination with other performance measures.

39 (IPPF) Attribute Standard 1300 – Quality Assurance and Improvement Program.
40 (IPPF) Practice Advisory 1300-1: Quality Assurance and Improvement Program.
41 Chen, Jiin-Feng and Wan-Ying Lin, Table 4-1: Ranking of Methods Used to Measure the Performance of Internal Audit Activities, page 40.
42 (IPPF) Performance Standard 2060 – Reporting to Senior Management and the Board.
**Audit Client Surveys:**
CAEs can assess the value of the internal audit activity through client surveys. The goal of client surveys is to give CAEs insight regarding the perceived contribution of audit engagements. Surveys can be very effective if carefully designed and administered to avoid ambiguity and foster candid responses from stakeholders. Additionally, the effectiveness of surveys can be limited by the CAE’s ability to accurately interpret the results and respond accordingly.

**Other Internal Audit Performance Metrics**
To remain relevant within the organization, CAEs should seek performance measures that are highly correlated with the actual value of the internal audit activity. Other internal audit performance metrics that might convey the audit function’s contribution are listed below:

**Number of Personnel Exported into Leadership Positions:**
Internal audit departments are often viewed as a talent pool and management training ground. After only a few years in the internal audit department, personnel can gain an enterprise-wide understanding of the organization’s operations. The number of former internal audit personnel in management positions can reflect the department’s ability to develop leaders capable of adding value to the organization. Additionally, well-designed rotational audit programs and “guest audits” can allow employees to gain operational experience and critical business skills while simultaneously exporting governance, risk, and control awareness throughout the organization.

**External Quality Assessment Review (QAR):**
Approximately 51 percent of the CBOK study respondents indicate that their internal audit activity has never undergone an external quality assessment review (QAR). These external assessments are required at least once every five years and express an opinion over the “entire spectrum of assurance and consulting work performed by the internal audit activity” to help CAEs gauge and improve internal audit performance. The findings of the external QAR should be communicated to key stakeholders, implicitly displaying the internal audit activity’s commitment to quality, transparency, and continuous improvement.

**Balanced Scorecard:**
The 2010-2011 CBOK study reveals that the balanced scorecard, while not widely used by internal audit departments today, is expected to be used in the future. The balanced scorecard approach can link internal audit performance with the organization’s strategy. Additionally, CAEs can obtain peer data from resources such as The IIA’s Global Audit Information Network (GAIN) to effectively benchmark the internal audit activity.

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43 Bailey, James, pp. 36-38.
44 (IPPF) Practice Advisory 1312-1: External Assessments.
Informal Metrics/“Poster Child Audits”:
Internal auditors can also evaluate their perceived contribution through informal metrics such as impromptu conversations with stakeholders in the hallway or break room. Audit clients who eagerly discuss recent engagements or seek advice from internal auditors can convey the audit activity’s perceived value as well as identify issues to consider when planning future engagements. These informal interactions not only develop critical relationships with stakeholders, but can also communicate internal audit performance.

Philip Roush, Vice President-Governance, Risk, and Controls at Cisco Systems, advocates “poster child audits” as an informal performance metric for his department. Roush defines “poster child audits” as specific engagements that stakeholders immediately recognize as adding value for the organization. He states, “When I came to Cisco, I asked the CFO, ‘In your memory, what are two or three of the big impact items that internal audit has had in the past few years?’ He sat there, and I knew I had frustrated him, and said, ‘Oh, they do good work.’ I didn’t push him but it proved an obvious opportunity for poster child audits.” Roush further adds, “If your CEO or CFO can’t say, ‘Wow, this is where internal audit had an impact,’ then you may need to think about what you’re doing or at least putting your energy in the right places.”

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47 Roush, Philip, “How Internal Audit Can Add Value to the Organization,” AuditChannel.tv
Conclusion

The CBOK study has provided significant insight into internal auditing. The profession will continue to evolve and must continually reposition itself to provide value for its stakeholders. Initiatives by The IIA, such as the Common Body of Knowledge, document the profession’s evolution and identify emerging value-add opportunities for internal auditors. CAEs must ensure the audit activity adds value through objective analysis of business processes resulting in transparent reporting to stakeholders, as opposed to a simple “check-the-box” audit mentality.

Internal auditing’s relevance is directly related to the perceptions of key stakeholders such as the board of directors, senior management, and operational management. CAEs must develop strong relationships with these stakeholders to understand their needs, expectations, and perceptions. Additionally, CAEs must actively promote the value-add capabilities of the internal audit activity. Achieving the organization’s full potential undoubtedly requires open communication and alignment between internal auditors and their stakeholders.

Internal auditors must remain cognizant of conditions that impair independence or objectivity. The Value Proposition of internal auditing is centered on “objectivity, assurance, and insight.” An impairment of objectivity could threaten credibility and diminish the perceived value of assurance and insight provided by the internal audit activity.

The contributions of the internal audit function are correlated with internal auditors’ ability to anticipate and adapt to change. The objectives, environment, stakeholders, and risks of an organization are dynamic. Internal auditors must be responsive to change and emerge as trusted advisors capable of providing objective assurance and insight in the midst of uncertainty.

Rob Walls, Chief Audit Executive at Cajun Industries, emphasizes that internal auditors must also strengthen their individual personal brand to continuously add value for stakeholders. He explains, “We invest in ourselves to add value for the organization. We must continuously gain knowledge in order to transfer knowledge. The Standards require competence, but you should go beyond and strive for expertise.” While compliance with the Standards is fundamental to the profession, Walls further adds, “You have to set personal standards that continuously enhance your knowledge, experience, communication skills, and all of the other factors that feed into your personal brand and define who you are. When taken together, you begin to realize your potential. You’re no longer showing up for the job... you’re adding valuable contributions and have become a trusted advisor across the entity.”

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48 “Internal Auditing: Assurance, Insight, and Objectivity,” (Altamonte Springs, FL: The Institute of Internal Auditors)
http://www.theiia.org/theiia/about-the-profession/value-proposition/
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