

# 13

## **The value of the internal audit function and the risk of not engaging**

### **The Institute of Internal Auditors**

Carey S. Blakeman, *Director, Corporate Governance Engagement*

Audit committees champion a culture of accountability and compliance, recognizing that their judgments and decisions influence stakeholder views, including those of shareholders, regulators, and employees. By upholding these principles, boards and audit committees collectively contribute to creating and protecting investor value, fostering trust in capital markets, and promoting the long-term sustainability of their organizations. Internal auditors support this culture by assessing and providing insight into the sufficiency of an organization's control and risk management environment, instilling greater trust and confidence in an organization's operations and enhancing its ability to serve the public interest.

To achieve that trust, however, all stakeholders—especially the board and audit committee—must have a common understanding of what internal auditing is, the scope of its activities, and how it is distinct from other professions. The Institute of Internal Auditors' (IIA's)<sup>1</sup> Global Internal Audit Standards<sup>TM2</sup> defines internal auditing as:

*"An independent, objective assurance and advisory service designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of governance, risk management, and control processes."*

Because audit committees play a critical role as liaisons between the leader of the internal audit function—often referred to as the chief audit executive (CAE)—and the board, all members of the committee should understand the standards internal auditors must follow and how the function can best serve the organization.

### What internal audit functions do

An internal audit function's responsibilities extend beyond compliance with internal controls over financial reporting to address an organization's broader risk landscape. An internal audit plan focuses on assessing the key internal controls designed to mitigate the top risks of the organization. Depending on the organization and industry, an internal audit plan could include audits (also called assurance engagements) of cybersecurity, information technology (IT), human resources/culture, data privacy and protection, artificial intelligence (AI), fraud, business continuity, market risk, regulatory risk, etc. The plan should be risk-based and dynamic, adjusting to reflect organizational changes and goals. Because internal audits provide coverage of all risks, the plan is usually executed on a cyclical, rotating basis. In addition to assurance, internal auditors may also provide advisory services to further assist their organization.

The internal audit function, mandated by the board through a charter, serves as a key mechanism to assess how well key organizational risks are mitigated, thereby enhancing governance and protecting shareholder value. This function brings a systematic and disciplined approach to identifying risks, evaluating governance frameworks, assessing key processes and controls, and recommending improvements. Internal audit teams provide boards, audit committees, and management with important data around how well the organization's key risks are being mitigated. This work contributes to safeguarding and sustaining organizational value through the internal audit function's independent, objective assurance and advisory services. Internal audit's work aligns governance, risk management, and control activities with key risks and stakeholder priorities, reinforcing trust and confidence in corporate operations.

### Where the internal audit function is organizationally positioned

Internal audit functions may be located within the organization,<sup>3</sup> co-sourced (where a portion of internal audit services are outsourced), or fully outsourced (where the entire function is contracted out).

No matter the model, internal audit must report *directly* to the board for the function to be truly independent and effective. The board facilitates this independence through the tone it sets and the approval of the internal audit charter. When this reporting structure is not independent of management, issues may arise, including potential scope limitations or pressure on the internal auditors. The CAE should have an administrative reporting line to the chief executive officer, or equivalent, to support daily activities and ensure the work of the internal audit function is given due consideration.

### Essential risk oversight responsibilities of board and audit committees

Audit committees are vital to risk oversight and ensuring the effectiveness of the internal audit function. For audit committees to fulfill their responsibilities, they must ensure the internal audit function is independent, well-resourced, and empowered to operate at the highest levels of the organization. According to The IIA's Standards, the purpose of internal auditing is to:

*"[S]trengthen the organization's ability to create, protect, and sustain value by providing the board and management with independent, risk-based, and objective assurance, advice, insight, and foresight."*

For this to occur, audit committees must recognize the unique contributions of

internal auditors and actively support their mandate. In addition to their traditional financial reporting responsibilities, boards and audit committees are being asked to focus more on cybersecurity, business resilience, enterprise risk management, and AI. Internal audit functions are already working in these areas—or at least they should be. Audit committees should clearly communicate their expectations of internal audit and use its work to gather valuable insight and lessen the committee's workload. Corporate governance policies must preserve the scope, independence, and objectivity of internal auditors to allow them to deliver maximum value.

### What boards should look for

#### 1. Oversight and independence:

- Boards should approve the internal audit charter, which includes the internal audit mandate and the scope and types of internal audit services as stated in Domain III: Governing the Internal Audit Function of The IIA's Standards. This domain presents the responsibilities of the CAE as well as the support of board and senior management needed for internal auditing to be most effective. The board—not management—also approves the internal audit budget, whether the function is in-house or outsourced.
- The internal audit function should operate under a board-approved charter that defines its authority, role, and responsibilities. When defining the internal audit function's responsibilities, conversations should occur among the CAE, senior management, and the board. These conversations create awareness and build trust, which is critical to the three-way partnership. As required in The IIA's Standards, the CAE must provide the board and senior

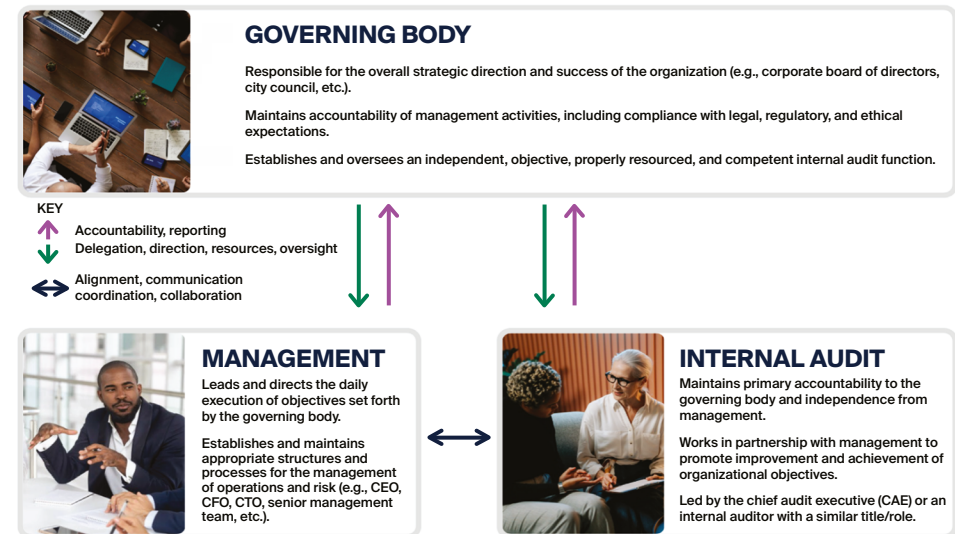
management with the information necessary to establish the internal audit mandate.

- The audit committee should ensure management implements recommendations from the internal audit function.
- The IIA includes a visual of organizational and governance reporting lines in its Three Lines Model.<sup>4</sup> Figure 1 outlines a well-positioned and effective governance and reporting structure and explains how each role and responsibility contributes to an organization's success. The internal audit function's independent assurance role is unique within an organization, which positions it to play a vital role in organizational value creation and protection.

#### 2. Standards and quality:

- To be successful, internal audit functions should adhere to The IIA's Standards, which are globally recognized.
- In addition to having a written charter and following the Standards, internal audit functions should:
  1. **Be independent from management.** Internal auditors should be directly accountable to the audit committee or the governing body.
  2. **Have qualified staff.** This can be demonstrated through such means as holding appropriate certifications or other credentials, such as the Certified Internal Auditor® (CIA®) and specialty credentials related to expertise in areas or topics subject to an internal audit.
  3. **Be objective.** Internal auditors should perform activities in an objective and unbiased manner.

**Figure 1. Governance reporting lines**



4. **Have an external quality assessment** (i.e. an audit of the internal audit function). Examples include The IIA's External Quality Assessment, a self-assessment with independent validation, or any alternative, high-quality private sector equivalent. Assessments should be conducted at least once every five years.
3. **Broad risk coverage:**
    - Internal auditors assess risks across the organization beyond financial controls. These can include, but are not limited to cybersecurity, sustainability reporting, use of AI, data privacy and protection, and supply chain integrity.
    - This comprehensive risk focus ensures the organization is well-prepared to address emerging threats and opportunities.

### Enhancing the value of internal audit

Audit committees sometimes underestimate the value of internal audit functions. As noted in The IIA's Global Public Policy Position Paper (see source from Figure 2):

*"While external financial audits are an important public protection, they do not cover the breadth of assurance provided by internal audit functions. Internal auditors look holistically at an organization, providing independent objective assurance over not just financial internal controls, but also over internal controls related to cybersecurity, data privacy and protection, supply chain risks, ESG/ climate and sustainability reporting, human capital, artificial intelligence, corporate governance, and a whole host of other areas vital to the operational success of the organization."*

**Figure 2.** The internal audit function



Source: A Legal, Regulatory, and Policy Framework for the Internal Audit Profession,<sup>5</sup> an IIA Global Public Policy Position Paper (GP4)

To address this issue, boards need to:

- Understand the strategic role of internal auditing in risk management and governance.
- Ensure the CAE has direct access to the audit committee to provide unfiltered insights.
- Support the internal audit function in building expertise in critical areas like fraud prevention, ethics, and organizational culture, as well as in emerging areas like cybersecurity risk and AI.

By actively engaging with the internal audit function, audit committees can ensure their organizations are equipped to navigate complex risk environments, thereby protecting stakeholders and fostering long-term success.

### A vision of the future

The Internal Audit Foundation's<sup>6</sup> Vision 2035 reports, released in July 2024, outlines the internal audit profession's challenges and opportunities as it adapts to an evolving risk landscape and technological advancements. Key insights were gathered

from more than 7000 stakeholders from around the world. According to the report, "there is both a strong desire and, more importantly, a need for internal auditors to confront the challenges of today and the future to achieve the profession's vision and fulfill its purpose."

### Key findings

#### 1. The evolving role of the internal auditor:

- Internal auditors must expand from providing traditional assurance services to becoming strategic advisors, leveraging insights and foresight to help boards and management achieve objectives. Vision 2035 states:

*"Today, internal auditors primarily provide objective, independent assurance to executive management and governing bodies. They confirm the comprehensiveness and reliability of the organization's governance processes, assess the adequacy of internal controls in mitigating risks, and ensure that the business operates as intended to achieve its objectives, protect*

*stakeholders, and serve the public interest. In addition, as part of these assurance services, internal audit makes recommendations to strengthen internal controls and holds management accountable for implementing actions to improve risk management. Both actions are required by The IIA's Global Internal Audit Standards™."*

Based on the research results, the top areas worldwide where internal auditors provide assurance and/or advisory services, either individually or as part of their internal audit function, include:

- operations/processes (75% personally, 87% function);
- compliance (69%, 82%); and
- risk management (63%, 77%).

The areas where internal auditors are less likely to provide services include:

- external financial reporting (18% personally; 29% function); and
- sustainability (21%, 34%).
- As risks become more complex, internal audit functions must address broader areas beyond financial reporting, including cybersecurity, sustainability, and AI. Vision 2035 reports an increase in what will be expected of the internal audit scope in the areas of cybersecurity and sustainability (see *Figure 3*).

### 2. Stakeholder support and independence:

- Audit committees and boards must reinforce internal audit's independence, ensuring the CAE reports directly to them and operates without interference. According to The IIA's Standards, the CAE needs to be positioned at a level within the organization that enables the

internal audit function to perform its services and responsibilities without interference.

- Greater collaboration among boards, senior management, and internal auditors is needed to enhance the profession's value. Vision 2035 research finds 45% of survey respondents indicate a need for more support from leadership and stakeholders.
- CAEs or leaders of internal audit functions must be strategically positioned within organizations and preferably hold certifications like the CIA® to effectively lead internal audit functions.

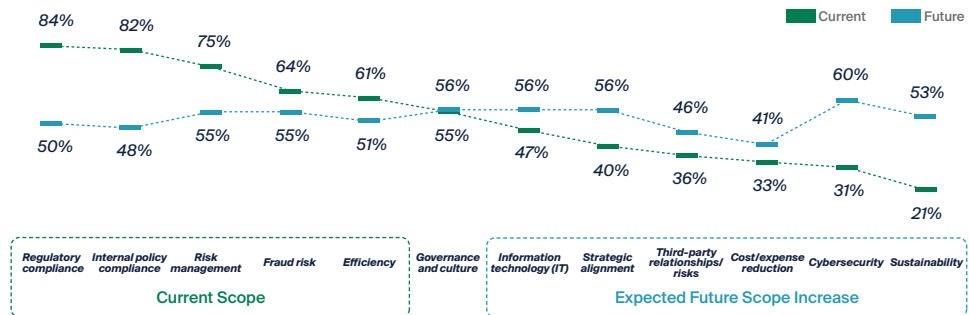
### 3. Technology's impact:

- Advanced technologies are reshaping how internal audits are conducted. Boards must ensure internal audit teams are equipped to use and assess emerging technologies, such as AI, while addressing related risks. These emerging technologies will influence how internal audit functions and teams complete their work while also improving quality and providing new opportunities to add value.
- Eighty-seven percent of Vision 2035 respondents agree that failing to adopt new technologies would hinder the internal audit's ability to manage risks. Internal auditors will need more support from boards and audit committees to ensure the function has the appropriate technology to fulfill the internal audit charter and to train on the skills necessary to assess the technology.

### 4. Upskilling and talent development:

- Internal auditors must acquire new skills, either by hiring experts, co-sourcing, or upskilling existing teams. Talent strategies must attract

**Figure 3.** Current and future audit scopes



Source: Internal Audit: Vision 2035 Survey<sup>7</sup>

diverse professionals with technical and strategic capabilities.

### Questions boards should ask internal audit leaders:

To assess the internal audit function's effectiveness, audit committees can ask the CAE several questions.

#### 1. Independence and governance:

- Is the internal audit function positioned independently to provide unbiased assurance and advice?
- Are there any organizational structures or reporting lines that could compromise the internal audit function's independence?
- What other areas of the business (e.g., risk or compliance) is the CAE managing?
- Is the internal audit function following The IIA's Standards?
- When was the last time an external quality assessment, or the equivalent, was performed?

#### 2. Collaboration and stakeholder engagement:

- How does the internal audit function collaborate with other stakeholders to maximize its value to the organization?

- Does the board and management provide adequate support to enhance the internal audit function's impact?

#### 3. Strategic role and advisory services:

- How is the internal audit function evolving to address strategic risks such as cybersecurity, sustainability, and emerging technologies?
- In what ways is the internal audit function contributing beyond assurance to become a strategic advisor?

#### 4. Technology integration:

- What technologies does the internal audit function leverage to enhance efficiency and accuracy?
- How are emerging technology risks being evaluated and managed?

#### 5. Talent and expertise:

- What strategies are in place to attract and retain talent with the necessary skills for future challenges?
- Does the organization invest in sufficient training and development to prepare the internal audit function for emerging risks?
- Does the internal audit function have enough skilled staff to achieve the internal audit strategy and plan?

### Conclusion

The internal audit profession's ability to evolve and meet future challenges hinges on the full support of boards and their audit committees. By aligning with organizational strategies and demonstrating measurable value through advisory and assurance engagements, internal audit can surpass outdated perceptions and become a trusted strategic partner.

To increase the support for and value of the internal audit function, board members and senior executives need to communicate the value offered by internal audit throughout the organization. Senior executives should also support the CAE's participation (non-voting) in key management meetings and executive steering committee meetings (i.e. give them a seat at the table).

This is a two-way street. To do their part, the CAE and internal audit leadership must effectively communicate their contributions to the board. Internal audit needs to stay updated on the latest business or operations initiatives and provide real-time advice, insight, and foresight.

By addressing these issues and engaging with CAEs more frequently, boards and their audit committees can ensure that their internal audit functions remain future ready, strategically aligned, and equipped to handle the complexities of tomorrow's risk landscape.

### Chapter notes

1 The Institute of Internal Auditors (IIA) is an international professional association that serves more than 255,000 global

members and has awarded more than 200,000 CIA® certifications worldwide. Established in 1941, the IIA is recognized throughout the world as the internal audit profession's leader in standards, certifications, education, research, and technical guidance. For more information, visit [theiia.org](https://theiia.org).

- 2 Global Internal Audit Standards™ [https://www.theiia.org/globalassets/site/standards/editable-versions/globalinternalauditstandards\\_2024january9\\_editable.pdf](https://www.theiia.org/globalassets/site/standards/editable-versions/globalinternalauditstandards_2024january9_editable.pdf).
- 3 Internal Auditing's Role in Governing Body/ Executive Committees <https://www.theiia.org/en/content/position-papers/2019/internal-auditing-role-in-governing-bodyexecutive-committees/>.
- 4 The IIA's Three Lines Model <https://www.theiia.org/en/content/position-papers/2020/the-iias-three-lines-model-an-update-of-the-three-lines-of-defense/>.
- 5 [https://www.theiia.org/globalassets/site/content/position-papers/2024/iaa-global-public-policy-position-paper\\_gp4.pdf](https://www.theiia.org/globalassets/site/content/position-papers/2024/iaa-global-public-policy-position-paper_gp4.pdf).
- 6 The Internal Audit Foundation is an essential global resource for advancing the internal audit profession. Foundation-funded research provides internal audit practitioners and their stakeholders with insight on emerging topics and promotes and advances the value of the internal audit profession globally. In addition, through its Academic Fund, the Foundation supports the profession's future by providing grants to students, educators, and academic institutions across the globe who participate in The IIA's academic programs. For more information, visit [theiia.org/Foundation](https://theiia.org/Foundation).
- 7 Internal Audit: Vision 2035 <https://www.theiia.org/globalassets/site/foundation/latest-research-and-products/vision-2035-report.pdf>.