

Defining, Measuring, and Communicating the Value of Internal Audit

Best Practices for the Profession

Marc Eulerich, CIA
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Contents

Executive Summary	7
Acknowledgments.....	8
About the Authors.....	9
Chapter 1: Introduction.....	10
Chapter 2: Research Questions and Research Method	12
Chapter 3: Defining the Value	14
Chapter 4: Measuring the Value	28
Chapter 5: Communicating the Value.....	38
Chapter 6: Conclusion and Overall Best Practices	43
Appendix: Detailed Participant Information	46
Interview Participants	46
Survey Participants	47
References.....	49
Internal Audit Foundation Sponsor Recognition	51
Internal Audit Foundation Board of Trustees.....	52
Internal Audit Foundation Committee of Research and Education Advisors.....	53

List of Figures and Tables

- Figure 3.1:** Word Cloud: How Internal Auditors Define the Value
- Figure 3.2:** Evolution of Internal Audit Activities
- Figure 3.3:** Overall Rating of Added Value by the Internal Audit Function
- Figure 3.4:** Self-Evaluation of Added Value by Internal Audit Functions by Company Size (Overall on a 5-Point Likert Scale and Proportion of High-Quality Internal Audit Functions)
- Figure 3.5:** Average Value Rating by Industry Type on a 5-Point Likert Scale
- Figure 3.6:** Average Value Rating by Industry Type and Comparison of High-Value and Low-Value Internal Audit Functions
- Figure 3.7:** Stakeholder Satisfaction Based on Self-Assessment by Internal Auditors
- Figure 3.8:** Satisfaction by Staffing Evaluation
- Figure 3.9:** Satisfaction by Certification Evaluation
- Figure 4.1:** Tools and Methodologies to Measure Internal Audit's Value (Overall and High vs. Low Value Internal Audit Functions)
- Figure 4.2:** Measures, Indicators, and KPIs Used to Evaluate the Performance of Internal Audit (Overall and High vs. Low Value Internal Audit Functions)
- Figure 4.3:** Measures Based on Overall Evaluation for High vs. Low Value Internal Audit Functions (Overall and High vs. Low Value Internal Audit Functions)
- Figure 5.1:** Communicating Value to Various Stakeholders
- Figure 5.2:** Criteria for Evaluating the Work (Overall and Top Seven for High vs. Low Value Internal Audit Functions)
- Table 3.1:** Internal Audit Function Activities That Bring the Most Value to the Organization

Executive Summary

Internal auditors and internal audit functions have been struggling — some more than others — to find convincing answers addressing one fundamental question: What is the added value of internal auditing in the specific organizational context? This question is of particular relevance to internal auditors and the internal audit profession. On a micro level, that question bluntly challenges the contributions from internal auditing, and on a macro level, the legitimacy and relevance of internal auditing as a profession. Furthermore, this question is highly relevant to internal audit's key stakeholders, e.g., senior management and the audit committee.

This research provides insights into the applied practices addressing the value question and suggests concrete pointers on how to define, measure, and communicate the value of internal audit. Based on interviews with chief audit executives (CAEs) and a comprehensive global survey, we examine the following questions.

How do internal auditors and internal audit functions:

1. Define their added value to the organization?
2. Measure their added value — and which metrics do they use?
3. Communicate their added value?

The results of this study suggest a maturity model distinguishing the roles of internal audit as a governance, risk, and control (GRC) partner, trusted advisor, and value driver as maturing roles of the internal audit function. Assurance emerges as an overarching theme across all roles: The **GRC partner** delivers assurance services as core remit. The **trusted advisor** goes beyond to offer advice; however, often limited to subject matters in or associated with internal audit's core competencies in the GRC arena. The **value driver** goes further, cracks the traditional boundaries, and contributes to what truly matters in the respective organization, thereby also dealing with the not so familiar, the lesser or unknown subject matters, and the more complex issues.

To achieve a high level of added value, our identified best practices examples and the results from the survey suggest a four-step approach:

1. Clarify the expected added value with key stakeholders.
2. Define and align the added value within the internal audit function.
3. Create a transparent measurement model for the internal audit function.
4. Communicate the added value inside and outside the internal audit function.

With the different role models in mind, this approach can help internal audit functions clarify what the added value of internal audit should look like, how CAEs and key stakeholders can measure the success of the function, and how internal auditors and CAEs can communicate the added value.

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Chapter 1

Introduction

“The internal audit activity adds value to the organization (and its stakeholders) when it provides objective and relevant assurance, and contributes to the effectiveness and efficiency of governance, risk management, and control processes.”

—IIA, 2017

Although this definition, taken from The IIA's International Professional Practice Framework (IPPF), seems to be simple and clear at first glance, the understanding of internal audit's added value varies widely between internal auditors and organizations. Over a decade ago, Bailey et al. (2003) and Gramling et al. (2004) were the first to inspire a growing academic community as well as practitioners with research focusing on internal audit's value creation. But even more than 15 years after these first contributions, the central questions regarding the value added by internal audit are still not answered satisfactorily. Internal audit's perceived value and its standing in the profession itself and among its stakeholders is still often described as hazy and enigmatic (e.g., Anderson, 2009; PWC, 2010, 2013; Lenz, 2013; Lenz and Hahn, 2015; IIA, 2013). Deloitte (2018) finds that only about 40 percent of CAEs believe that their function has strong impact and influence within the organization and only 46 percent think that stakeholders are aware of internal audit's services. In other words, more than 50% of internal audit's key stakeholders do not see the added value of their audit functions. Therefore, this study seeks to shed light on the value discussion in order to update practitioners on the current status of this fundamental topic and help them gain a detailed understanding of all aspects of internal audit's added value.

Because the satisfaction of internal audit's key stakeholders is one of the central challenges in the internal audit profession, it is important to understand the respective stakeholders' expectations when it comes to internal audit's value creation. In this context, most recent research by Roussy et al. (2020, p. 339) encourages internal auditors “to keep their eyes on the prize (i.e., on internal audit organizational significance)” in order to fight stakeholder disappointment. However, this is easier said than done. The internal audit function is an integral part of the organizational environment and typically serves “two or more masters,” including the audit committee, board, senior management (chief executive officer [CEO], chief financial officer [CFO], etc.), risk management, compliance, the external auditor, and the audit client. Hence, a multitude of stakeholders set their expectations toward the internal audit function, each defining his or her own view on the value internal audit should create. Furthermore, Lenz and Hahn (2015) show that there is a difference between the value internal auditors think they rendered and what their stakeholders perceive. The authors discuss the micro and macro perspective of internal audit activities and the challenges for CAEs and internal audit functions to satisfy the different stakeholders on the various levels. Our study provides new and unique insights into the current and future-oriented, modern internal audit practices and summarizes that information to improve our understanding of the internal audit function's added value. Detailed information on applied practices will help practicing internal auditors define, measure, and communicate their own value as well as their function's value. We furthermore

take a quick glance at “what good looks like” by giving a short list of best practices applied, which may give practitioners a role model to consider. Our results are relevant for both internal audit practitioners and academic researchers in the field of internal auditing and corporate governance, and should start a fruitful discussion within the profession and among researchers.

Chapter 2

Research Questions and Research Method

How to define, measure, and communicate the added value of the internal audit function is one of the central challenges of the profession, for both the internal audit function and for the stakeholders. This is of particular importance since the value of internal auditing cannot be exclusively characterized by its input (e.g., the number of internal auditors or number of audits performed) or its output (e.g., number of audits, findings, recommendations). To provide a complete picture, the type of services performed by the internal audit function, the role of the internal audit function within its organization (e.g., between watchdog and trusted advisor), and the quality of the internal audit function's work (e.g., focus on assurance vs. consulting activities) must also be discussed. This makes the discussion very subjective and the concrete definition depends on multiple factors, like stakeholder needs and resources of the internal audit function or regulatory environment. Before we present our research questions, we will start by describing the three typical perspectives of the added value discussion:

Define the value: The definition of the internal audit function's value is driven by numerous stakeholders' expectations and the activities performed by the internal audit function to meet these expectations (e.g., Eulerich et al., 2019; Eulerich et al., 2017). However, stakeholders' needs can have a very different focus. For instance, the audit committee might define the value of internal audit activities through the lens of internal controls and risk management, while the CEO may have a focus on process improvement.

Measure the value: Just as important as knowing how to define internal audit's value is knowing how to measure value creation appropriately. While the number of audits performed or the number of findings and recommendations can be easily counted, the value of an audit or the value of the internal audit function with its unique insights is certainly more than just a figure. Considering this, it is obvious that internal audit's value comprises qualitative (e.g., the satisfaction of stakeholders) as well as quantitative (e.g., the number of audits performed) characteristics, and that a potential measurement approach needs to integrate both.

Communicate the value: Once internal audit's value is defined and measured, it is important to establish a good way to report and communicate it to the organization and its key stakeholders. The information communicated should of course include the function's actual value as well as key stakeholders' feedback on the function's activities, since the reputation of the internal audit function is also influenced by the audit client's prior experiences. Since internal audit functions use a variety of communication channels, such as the audit report, the annual report, or personal meetings with the CEO or the audit committee, there is no general rule about which channel is used and how the actual value is communicated.

Based on the three dimensions discussed above, each of our research questions addresses major issues of traditional and modern internal audit functions. Thus, our main research questions are¹:

How do internal auditors and internal audit functions:

1. Define their added value to the organization?
2. Measure their added value and which metrics are used?
3. Communicate their added value?

Our research design follows a two-stage approach. In the first step, we use in-depth interviews with 11 CAEs to understand the main features of defining, measuring, and communicating value from CAEs' perspective. We chose organizations from different industries and countries to obtain a diverse representation of the profession. Furthermore, all interviewees work for organizations that can be evaluated as best practice companies and exhibit a well-developed maturity level of internal auditing based on self-perception. In the second step, we developed a questionnaire based on the qualitative interviews with the CAEs. The questionnaire comprises a set of closed- and open-ended questions on the internal audit functions' value creation from the perspective of internal auditors as well as their view on key stakeholder expectations.

In September 2019, the Internal Audit Foundation sent an email to global IIA chapters to introduce our study and invited them to circulate a link to our online survey to their members. The survey was sent to CAEs and internal auditors located in various countries and working in internal audit functions at different maturity levels in various industries. The online survey was open for approximately one month and 336 individuals responded. The data was analyzed and the results are presented in the following pages. Given the diversity of the CAEs interviewed and the internal auditors surveyed, we are able to analyze a wide variety of approaches currently being used. Our findings are therefore relevant for the majority of internal auditors. Copies of both the interview and the questionnaire are available upon request.

Note that this study uses the profound knowledge of internal audit leaders to understand internal audit's perspective as well as the perspective of its stakeholders. This is because stakeholders may not understand the breadth of internal audit's capabilities. Consequently, they may desire a less aggressive function that does not challenge the current state, and often the views of senior management and the audit committee differ on how they define value. The success of the internal audit function relies on its leadership and how they define, measure, and communicate the value they are adding to stakeholders.

¹ In addition to the three main research questions listed above, we define the following question, which is supposed to help deepen the understanding of the value discussion: How do internal audit functions' key stakeholders influence the discussion of internal audit's value?

Chapter 3

Defining the Value

“[What we] try to do is help the company identify the top risks, determine whether or not the management and risk management practices are adequate to deal with those risks or whether or not additional work needs to be done [...]. Then I’m providing the assurance that it’s in place and operating the way it should be [...]. I’m like your doctor or your dentist, I can’t brush your teeth for you, but I can tell you here are the steps you need to do to be healthy and I don’t want to be a police officer. I want to be that person that helps you get healthy, but I can’t do it for you.”

—CAE of a large multinational technology company

Views on Internal Audit’s Added Value

As a key finding, the interviewed CAEs state that the added value of internal audit is defined in particular by the requirements and expectations of internal audit’s key stakeholders, along with the individual characteristics of the respective company. It is senior management (C-level) and the audit committee that define and frame the basic conditions and broad direction of the internal audit function. In most cases, interviewees indicate that internal audit’s key stakeholders appreciate the ability of internal audit to identify current and future risks, assess their impact, and recommend procedures and controls to manage them. The assurance aspect of internal audit was especially mentioned by the interviewees, as well as special attention on emerging trends and topics.

“The audit committee and the management board know that we are going after the right topics and provide advice about these hot topics and we have a lot of them in our company. That is, I would say, our number one value. Number two, obviously, is that the audit committee and our board of management not only know that we go after the right topics, but that we have the competencies to tackle those topics.”

—CAE of a large, listed infrastructure company

The survey shows that from the internal auditors’ point of view, the key stakeholders consider the audit of financial controls and compliance (thus providing assurance to the stakeholders) as the primary task of internal audit.

audit's position and self-image (Sarens et al., 2016) in alignment with the aforementioned factors, it is crucial to properly assess “what is the current state” of the internal audit function. As can be easily imagined, there is a huge variety in the status of internal audit functions assessed. Internal audit means different things to different people in different organizations at different times, and there are different degrees of maturity in practice.

Internal Audit's Roles: GRC Partner, Trusted Advisor, or Value Driver?

For a more detailed analysis, we group the interviewees' answers into three clusters representing internal audit's possible roles or stages of development/maturity. They range from strongly traditional internal audit functions with a focus on GRC assurance to internal audit functions that combine audit and consulting activities to internal audit functions fully aligned with and contributing to the achievement of the overall (strategic) organizational objectives.

First Things First – Become a GRC Partner

Deliver your base product and service—assurance—well. Start with the traditional internal audit activities covering the areas of governance, risk management, and internal controls to protect the organization and help generate value. Earn your credentials and establish trust in the organization.

Before striving to provide a higher level of long-term and sustainable value, the internal audit function first has to gain credibility and trust within the organization. This can be done by offering relevant basic internal audit services and delivering high-quality assurance with a focus on GRC. Core remit of the GRC partner is value protection rather than additional value creation. As quoted from interviews with CAEs:

“Our value proposition cuts across all of the types of risks that the company sees, going from operational through financial and regulatory. We have to offer assurance for the audit committee and the C-level.”

—CAE of a large multinational company from the financial industry, C8

“We are providing the assurance: is everything (e.g., controls) in place and operating the way it should be?”

—CAE of a large listed multinational company, C6

Build Your Own Base – Become a Trusted Advisor

Strive for heightened efficiency and effectiveness, day by day, bit by bit. Leverage your reputation. Consider fresh and modern audit activities and/or approaches to optimize processes and structures, including (for example) continuous auditing, robotic process automation, etc., to strengthen positioning as a trusted advisor.

Once the internal audit function enjoys a solid reputation and the competence level has matured, the function may be ready for migrating into the role of trusted advisor. That role includes further potential for value creation via advisory-oriented activities, e.g., the improvement of key business systems or processes, thus increasing overall company performance (Chambers, 2017). The trusted advisor’s advice usually focuses on more familiar, known topics; is supply led; and is often associated with the GRC area.

In our interview study, we came across internal auditors who seem to — certainly in part — comply with the attributes of trusted advisors. For example:

“We are seen as the trusted advisor at least for management, we give them advice and also give the audit client advice, how they can do better. We are not only the bad ones, telling them what they are doing wrong. We also tell them how they can do better. Thus, it is important to be ready to switch your roles.”

—CAE of a large listed multinational company, C5

Create Strategic Value – Become a Value Driver

More fully align the internal audit function’s activities with the strategy of the organization to maximize the added value. Become a fully demand-driven internal audit function to support the board and management. Truly audit what matters to the success of the organization. Become a respected value driver of the organization.

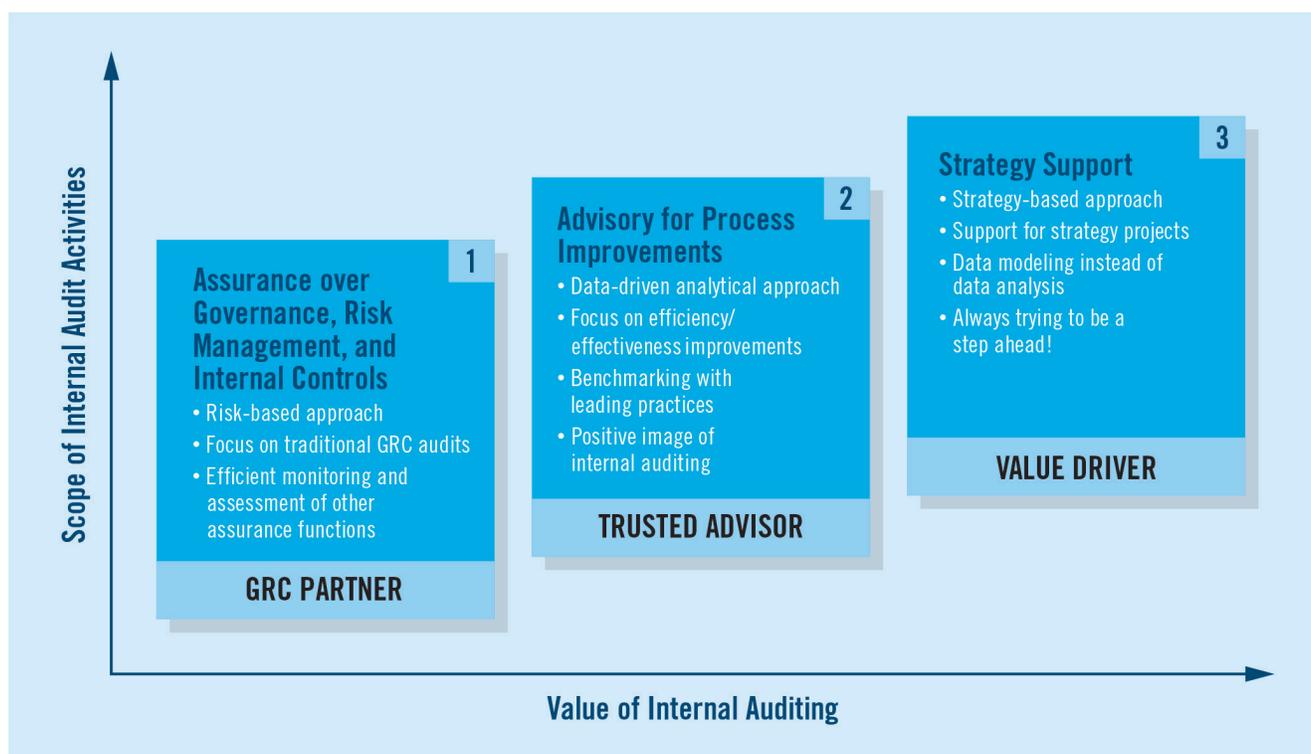
Once established as trusted advisor, the internal audit function may even step up to be perceived as an active value driver of the company’s success. In the ideal scenario, there is full alignment of all key internal audit activities with the corporate strategy. That way, companies are able to unlock the full potential of the internal audit function and may get the highest value out of it. The value driver thereby deals with not so familiar, lesser known, and more complex subjects. The

internal audit function’s advice is demand-driven, when entering the role of a value driver. The quote below suggests that some internal auditors are already entering the pioneering zone²:

“How would I define the strategic value of internal auditing? From the perspective of the person receiving the value, they (the stakeholders) are able to say, I can use this information from internal auditing. I needed this information and I can actually make things better.”

—CAE of a large national governmental organization, C4

Figure 3.2: Evolution of Internal Audit Activities



In the following sections, the individual value-adding areas (as they emerged from the survey) are presented and discussed in light of the three development and maturity levels mentioned before.

Activities That Bring the Most Value According to the Survey

We asked the survey participants to rate different activities of the internal audit function and identify the top five that bring the most value to their organizations. Interestingly, participants ranked assurance about adequacy and effectiveness in the areas of internal control system, risk management processes, and governance processes as their top three activities. This is largely in line with The IIA’s definition of internal auditing and IIA Standard 2100.

² See a detailed explanation of the “comfort zone” vs. “pioneering zone” concept in Lenz 2017.

Table 3.1 ranks the different activities from which survey participants chose their top three activities.

Table 3.1: Internal Audit Function Activities That Bring the Most Value to the Organization

Rank	Activity
1.	Assuring the adequacy and effectiveness of the organization’s internal control system
2.	Assuring the adequacy and effectiveness of the organization’s risk management processes
3.	Assuring the adequacy and effectiveness of the organization’s governance processes
4.	Recommending business and operational improvement
5.	Leading the enterprise risk assessment and management processes
6.	Assuring the adequacy and effectiveness of the organization’s regulatory compliance processes
7.	Identifying emerging risks
8.	Testing the adequacy and effectiveness of management’s assessment of controls
9.	Informing and advising the board/audit committee
10.	Informing and advising senior management
11.	Informing and advising management
12.	Investigating fraud
13.	Mining and analyzing data for management
14.	Assessing fraud risks and deterring fraud
15.	Supporting external auditors

The results show that from the internal auditors’ point of view, the core pillar of the profession remains to be the provision of assurance services. The top three activities follow The IIA’s definition of internal auditing and focus on assurance of internal controls, risk management, and governance processes. A value-adding internal audit function benefits from those core activities. Nevertheless, the quality and focus of the assurance services provided may vary. Most internal audit functions may provide traditional assurance services with traditional audit approaches to guarantee the necessary assurance (GRC partner). Others may go a step further and provide assurance that the processes are robust so that there is trustworthy indication that the respective organization is presently complying with particular expectations and exercises successful operational practices.

Those internal audit functions extend the traditional assurance focus and offer their unique insights with room for additional improvement. The perception of internal audit functions with helpful findings and recommendations is more positive than the traditional “watchdog internal auditing,” and it is possible that those internal audit functions are recognized as a trusted advisor (Chambers, 2017). The last stage is the internal audit functions that offer additional services and modern, best practice approaches (e.g., when it comes to data analytics and automation). These functions go beyond and help to create value through all internal audit activities. Although these functions will have to offer traditional assurance services, the added value comes through smart additional audit results, unique ways to audit (e.g., data-driven remote audits), and sophisticated audit procedures. This approach can help internal audit to maximize its own value, but most importantly to also maximize the value of the organization (value driver).

We asked the participants how they would rate the value added by their own internal audit functions (see **figure 3.3**). Notably, more than 90% of the participants rated their own audit function as creating added value (42.81% see a “moderate value” and 49.70% see a “significant value” of their audit function). This is a very positive self-evaluation and self-perception, and is in contrast to prior findings.

Figure 3.3: Overall Rating of Added Value by the Internal Audit Function

Self-Evaluation of Internal Audit's Added Value	Percentage of Participants
Significant Value	49.70%
Moderate Value	42.81%
Some Value	6.89%
Low Value	0.60%
Total	100.00%

Results for the Added Value Divided by Company Size

In the next step, we examined the extent to which differences in the value contribution of internal audit exist between different characteristics of the organizations. The value is measured on a 5-point Likert scale from “no value” to “significant value,” where higher ratings are associated with a higher value contribution. To do this, we first examined the size of the organization based on its “total assets,” “revenues,” and “number of employees” and divided it into categorical subgroups. We present the results for the self-evaluations about the added value for the different groups in **figure 3.4**. Furthermore, we analyzed the percentage of internal audit functions with a “significant value” in the specific subgroups (also shown in figure 3.4). In this context, an internal audit function is considered to be of an above average added value (high quality) if the auditors indicated that their audit provides significant added value. The results in figure 3.4 show that the value contribution between the groups is very similar. Each group rates the added value of the internal audit function between 4 “some value” and 5 “significant value.”

Company Size by Total Assets

Internal auditors of companies with less than USD \$1 billion total assets or more than USD \$10 billion total assets rate their value contribution at roughly 4.44. Companies with total assets between USD \$1 billion and USD \$10 billion rate their value contribution slightly lower (4.37) than the other companies. However, these differences are negligible. To dive deep into the results, we also examined whether the proportion of high-quality audit functions differs between the sizes of companies (measured by total assets). Since about half of the participants stated that they deliver significant value, this figure would have to be 50% in each group if the size of the company had no influence. Indeed, the results support our previous findings. The purporting of high-quality internal audit functions is close to 50% in each group. Again, differences are rather small and negligible. Similar to the average value rating by total assets, the results in figure 3.4 support that the size in total assets does not prevent internal auditors from contributing value to the organization.

Company Size by Revenues

To make sure that our inferences on internal auditors' value contribution and company size are correct, we also divide the organizations in different groups based on their revenues. Figure 3.4 shows that our results are robust to some extent. The average added value for most groups is between 4 "some value" and 5 "significant value." The average ratings vary between 4.41 and 4.46 for firms with more than USD \$100 million sales. On the one hand, we do not find lower value contributions in companies of moderate size, supporting the argument that the small deviations in figure 3.4 are negligible. On the other hand, we find that internal auditors from companies with less than USD \$100 million revenues perceive their value contribution slightly lower (4.33). However, it should be noted that these differences are still very small.

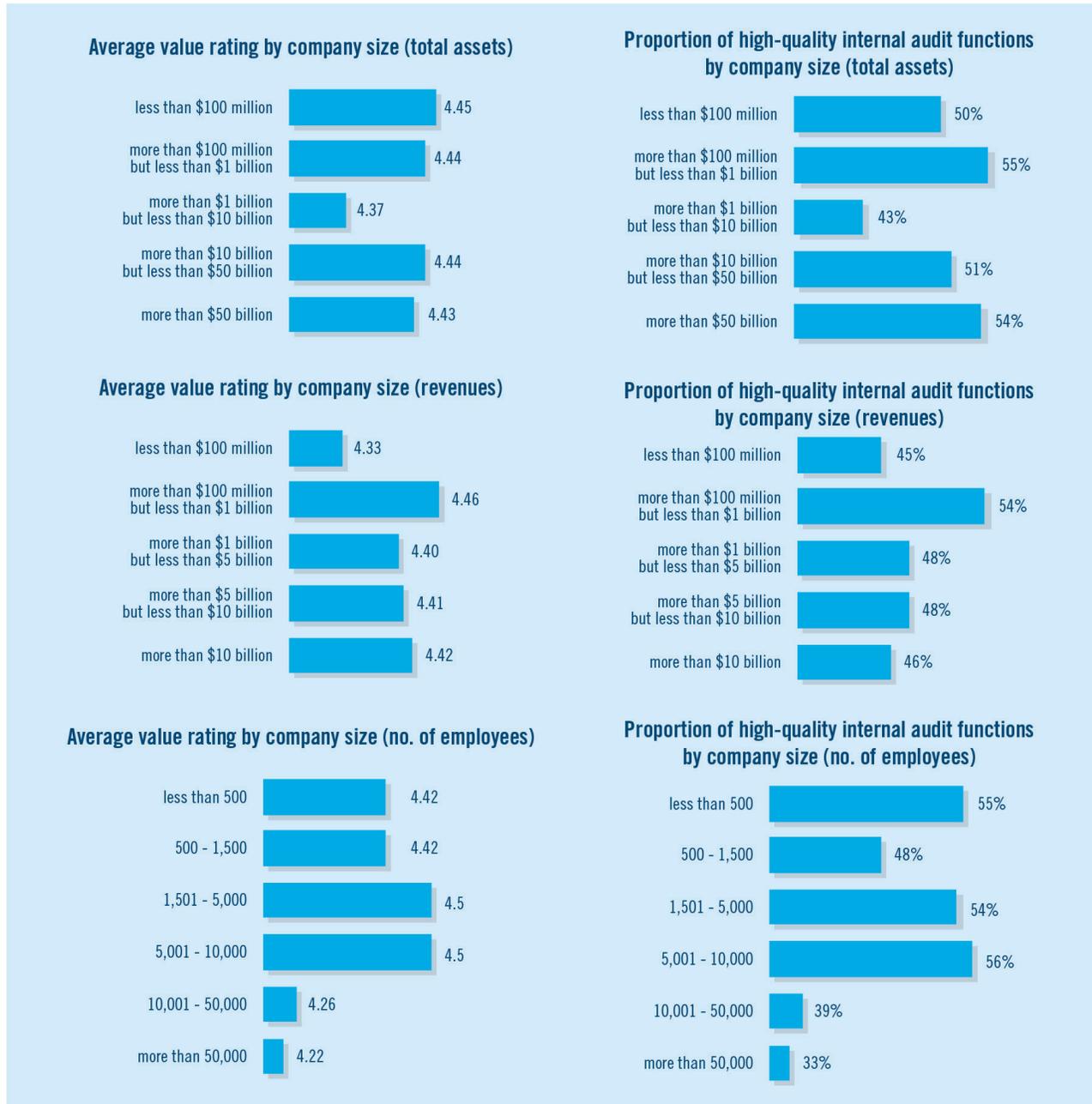
Furthermore, we compared the proportion of high-quality internal audit functions between the size classes based on revenues. Once again, we focus on deviations from 50%, because about half of the participants stated that they deliver significant value. So this figure would have to be 50% in each group if the size of the company has no influence. The purporting of high-quality internal audit functions is close to 50% in each group. However, we find 54% high-quality internal audit functions in companies with more than USD \$100 million revenues but less than USD \$1 billion revenues, and only 45% in companies with less than USD \$100 million revenues. However, these differences are rather small and negligible as they are not above 5%. Taken together, the comparison of value creation and different classes of size based on revenues yields no association between size and value creation. Internal auditors consistently perceive their activities as creating value across all sizes of companies.

Company Size by Number of Employees

Last, we compare the average value rating across different classes of size based on the number of employees. The results in figure 3.4 are somewhat different from our previous findings. Each group rates the value contribution between 4 “some value” and 5 “significant value,” but the ratings in companies with more than 10,000 employees are smaller. The average value rating of internal auditors in companies with not more than 10,000 employees is between 4.42 and 4.5. However, the average value rating of companies with between 10,001 and 50,000 employees is 4.26. The average value rating of companies with more than 50,000 employees is 4.22. In line with these results, we show the proportion of high-quality internal audit functions within the different classes of company size. We find a lower proportion of high-quality internal audit functions in companies with more than 10,000 employees. The proportion of high-quality internal audit functions is 39% (33%) in companies with between 10,001 and 50,000 (more than 50,000) employees.

Taken together, company size does not prevent internal auditors from adding value to the organization. The overall picture regarding total assets and revenues suggests that there is no association between company size and value creation. The results regarding the number of employees are slightly different from this finding. The higher the number of employees within the company, the lower the rated value of internal audit. In contrast to revenues and total assets, employees create information asymmetries within the company. Thus, internal auditors perceive it as more complicated to add value to the organization if the number of employees is high. The results in **figure 3.4** suggest that company size does not prevent internal auditors from pursuing their purpose: providing assurance and consulting services in order to add value. The internal auditors consistently perceive their activities as creating value across all sizes of companies.

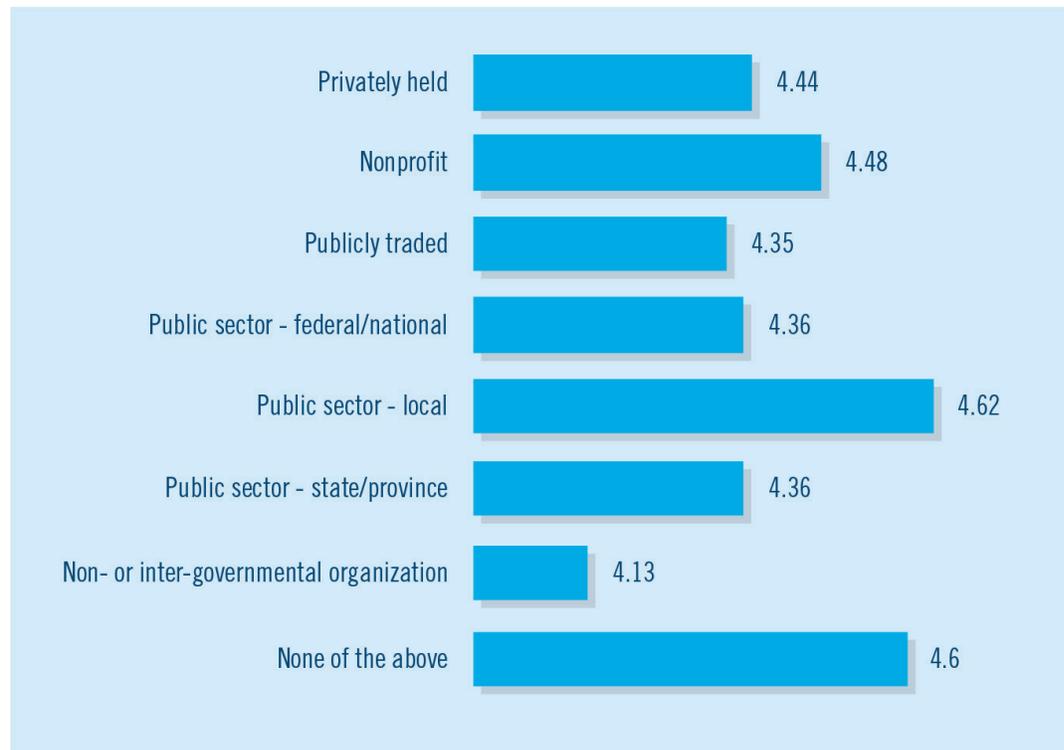
Figure 3.4: Self-Evaluation of Added Value by Internal Audit Functions by Company Size (Overall on a 5-Point Likert Scale and Proportion of High-Quality Internal Audit Functions)



Results for the Added Value by Company and Industry Type

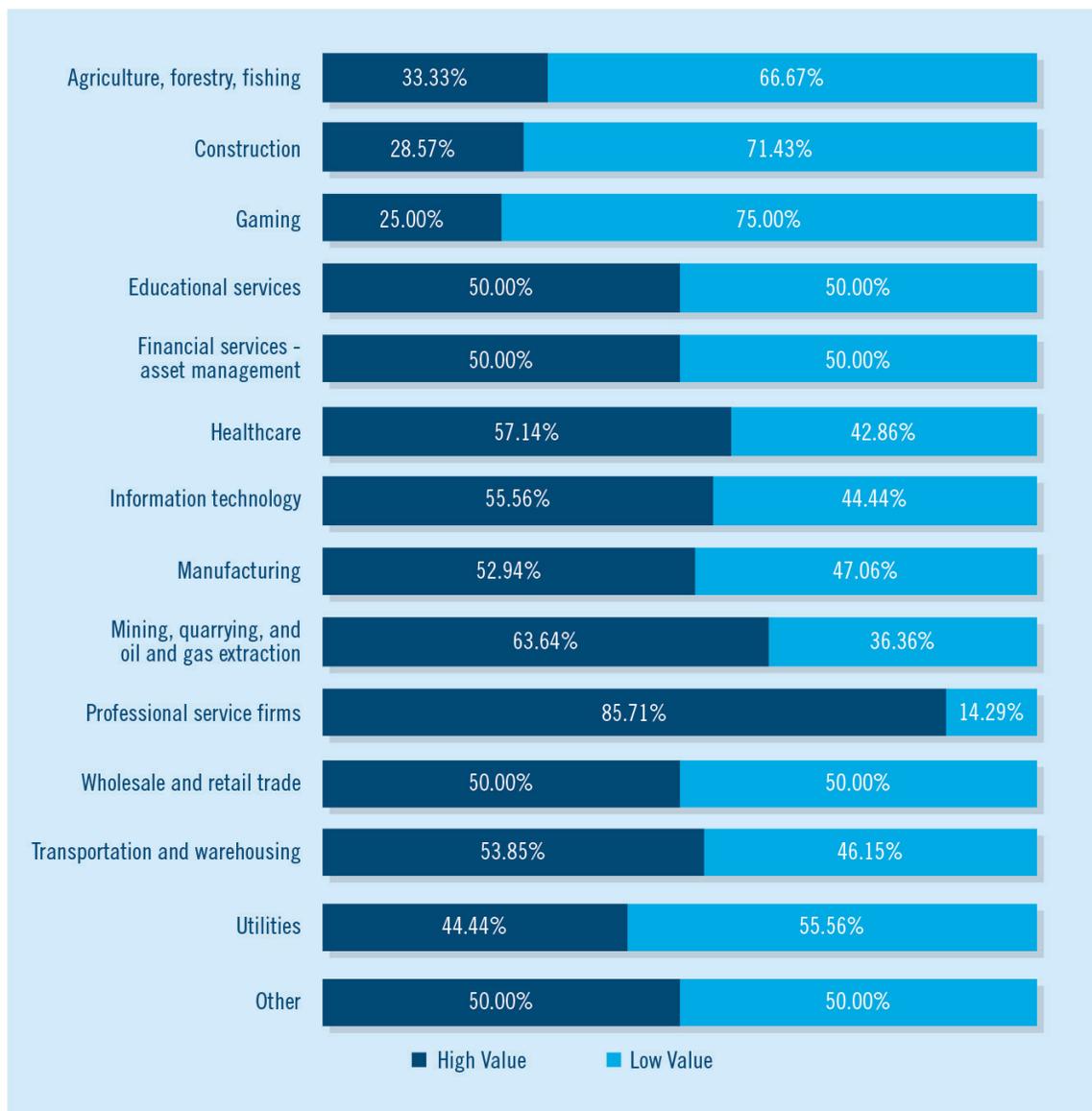
We also examined whether the type of organization has an influence on the value contribution of internal audit. In doing so, the organizations were divided into private, listed, and nonprofit, among others. **Figure 3.5** shows that the value contribution of internal audit differs between the types of organization. The average value rating in privately held companies is 4.44. Although the separation of ownership and control, and thus the need for an internal audit function, is higher in publicly traded companies, internal auditors of publicly traded companies rate their value creation slightly lower (4.35). Moreover, the value rating in nonprofit companies is higher (4.48). Especially within the public sector, there are huge differences between the different types of organizations. For instance, the average value rating of organizations in the public sector that operate locally is very high (4.62), while the average rating of the remaining organizations in the public sector is 4.36. Internal auditors of nongovernmental or intergovernmental organizations perceive their value lower than internal auditors from other industries. Their average value rating is the lowest (4.13).

Figure 3.5: Average Value Rating by Industry Type on a 5-Point Likert Scale



Furthermore, we compared the proportion of high-quality internal audit functions within different industries. The results in **figure 3.6** suggest that there are large differences between industries in terms of the value contribution of audit functions. Particularly striking are the low shares of value-adding audit functions within the agriculture, forestry, fishing, and hunting industry (33.3%), the construction industry (28.6%), and the gaming industry (25.0%). In contrast, the proportion of high-quality audit functions is particularly high in the professional service firms industry (85.7%) and the mining, quarrying, and oil and gas extraction industry (63.64%).

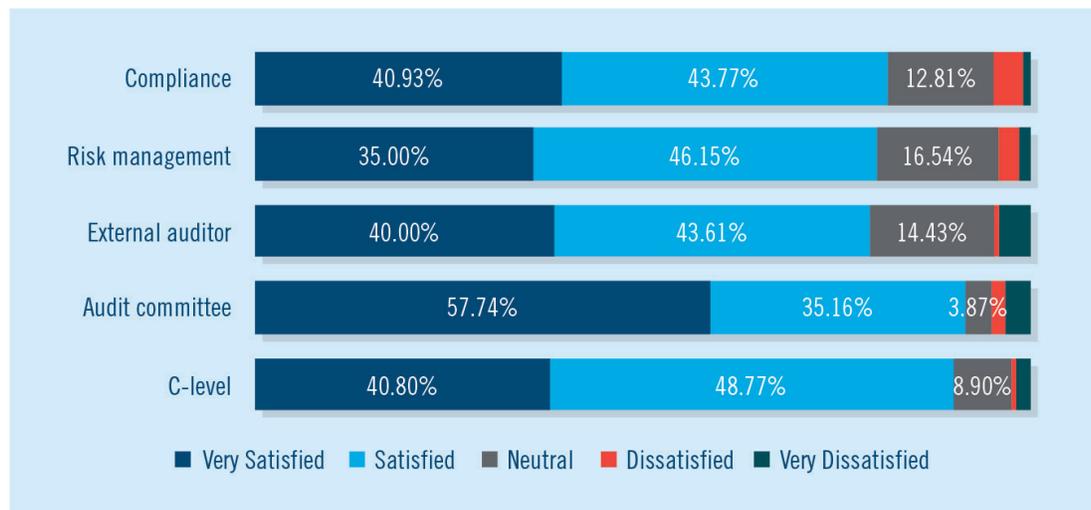
Figure 3.6: Average Value Rating by Industry Type and Comparison of High-Value and Low-Value Internal Audit Functions



Added Value Through Stakeholder Satisfaction

We asked the interviewees and survey participants to evaluate the satisfaction of different stakeholders from their point of view. Our detailed examination of the individual stakeholder satisfaction ratings by the participants also shows a positive picture. Survey participants indicate that more than 80% of the stakeholders are either “very satisfied” or “satisfied.” This is particularly pleasing, as the self-perception of audit leaders surveyed is that the audit committee and senior management (the two central stakeholders of internal audit) are very satisfied with the work. Furthermore, we can see that the neutral or negative evaluations are more often for second line of defense functions, like risk management or compliance, or the external auditor. Although these functions are important to stakeholders as well, the internal auditors seem to clearly focus on their main clients — senior management and the audit committee. A detailed analysis can be found in **figure 3.7**.

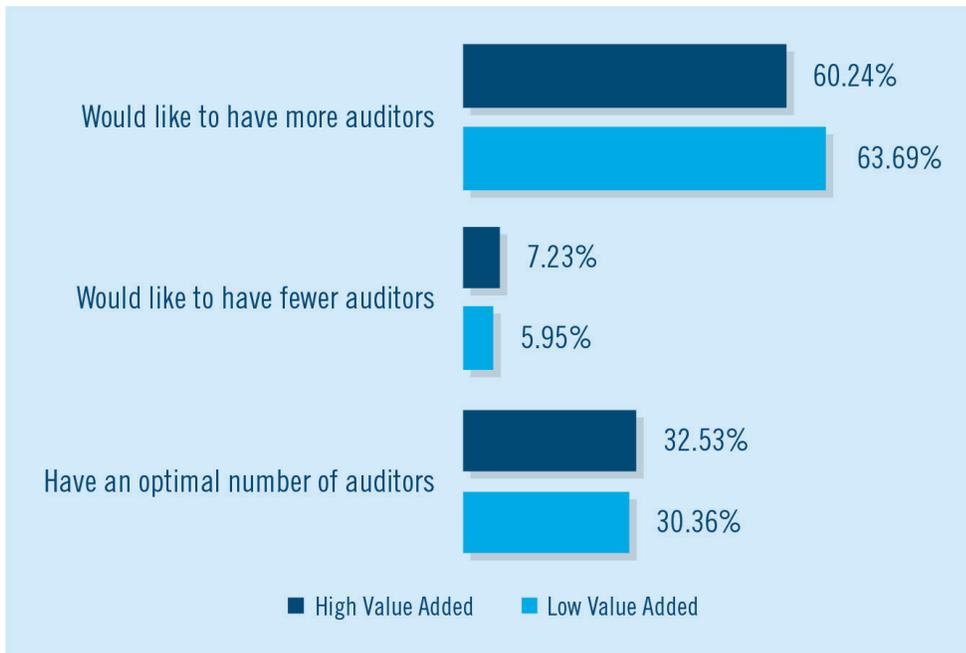
Figure 3.7: Stakeholder Satisfaction Based on Self-Assessment by Internal Auditors



Added Value and Staffing in the Internal Audit Function

One argument why audit functions are considered to be particularly valuable may be that they are adequately staffed. For this reason, we compared how high the auditors’ value contribution is assessed in relation to their perception of staffing levels. We divided our sample into two subgroups. The first group consists of all companies that have given above-average marks for the “added value” their internal audit function is creating. The second group includes all companies that were below the average of 4.4. We use this separation for multiple further analysis and to identify potential best practices. The detailed analysis shows that the companies with an above-average positive rating are more satisfied with their resources (32.53% vs. 30.36%). Nevertheless, more than 60% of the participants stated that more audit staff is still needed. Thus, a large internal audit function does not necessarily lead to a value-adding internal audit function, and there are still internal audit functions with an above-average added value that would like to have more internal auditors. See **figure 3.8**.

Figure 3.8: Satisfaction by Staffing Evaluation



A further argument could be that audit functions with a high level of expertise are more likely to deliver a high-value contribution. To this end, we compared the proportion of IIA and CPA certifications. The proportion of auditors with IIA or CPA certification is higher in companies with high value added (67.33% vs. 65.12%). Thus, professional certifications are key indicators for a high-value internal audit function (see **figure 3.9**).

Figure 3.9: Satisfaction by Certification Evaluation



Chapter 4

Measuring the Value

In this chapter, we summarize the applied practices on how to measure the value. We start with the results from our interviews, supplemented by the findings of the survey respondents.

The possible methods and tools to measure the performance is very diverse (see figure 4.1). The top three practices in the profession to measure the value are:

1. Key performance indicators (KPIs) (57.2%)
2. Surveys of audit clients or key stakeholders (51.8%)
3. Results of an external quality assessment (45.2%)

A comparison between the internal audit functions with high vs. low levels of added value does not reveal any significant differences. It is merely striking that high-quality audit functions more often rely on reviews by external regulators (such as banking supervision, external auditor, etc.) (29%).

Figure 4.1: Tools and Methodologies to Measure Internal Audit’s Value (Overall and High vs. Low Value Internal Audit Functions)

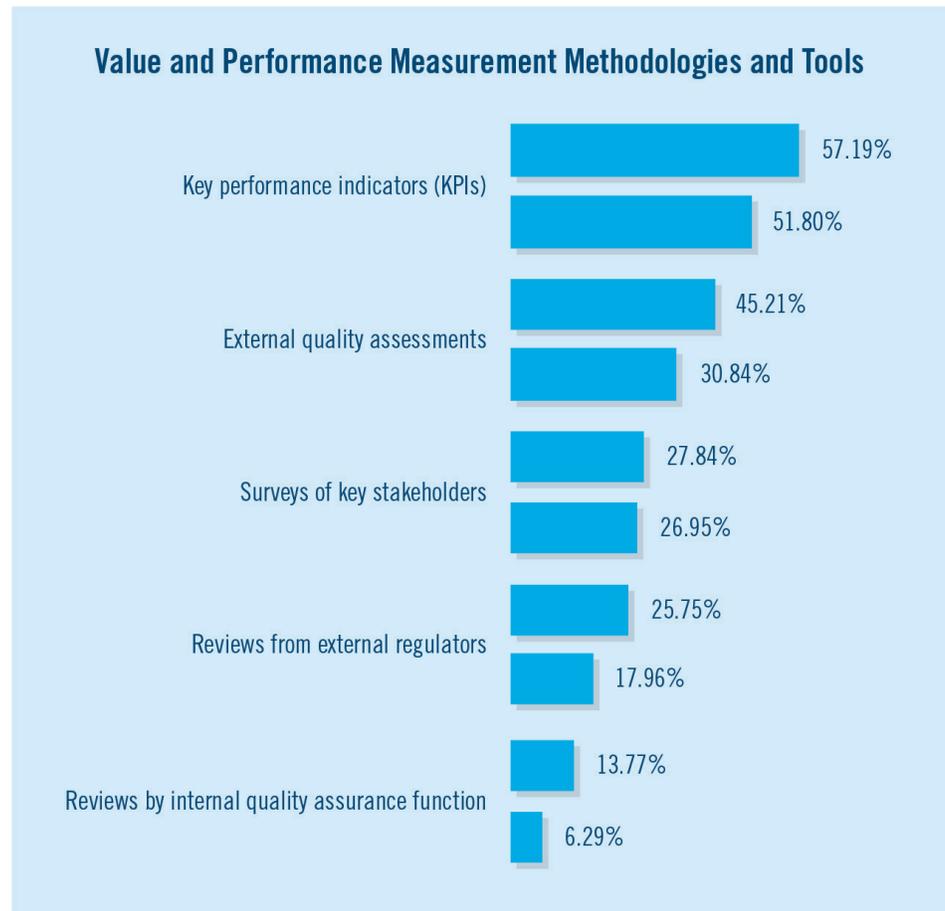
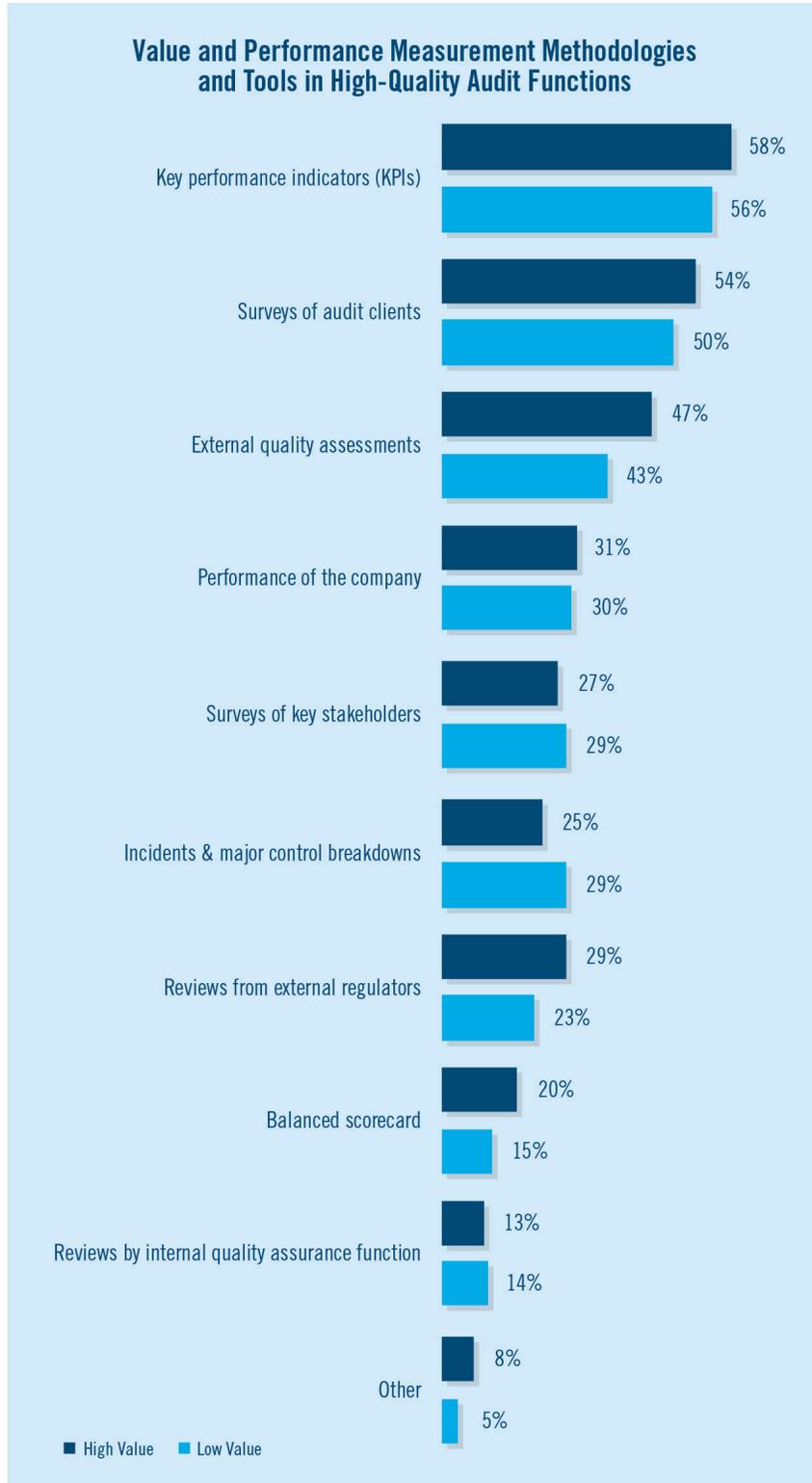


Figure 4.1: Tools and Methodologies to Measure Internal Audit’s Value (Overall and High vs. Low Value Internal Audit Functions) (cont.)



Key Performance Indicators of the Internal Audit Function

Most of the used indicators are well-known KPIs, such as “percentage of audit plan completion” (81.44%) or “timely closure of audit issues” (55.69%) (see **figure 4.2**). Nevertheless, there are also company-specific solutions (company-specific KPIs) that are used by more than 55%. However, key figures for adhering to the specified budget (42.22%) or the processing time for reporting (31.74% and 24.85%, respectively) are also common practice. Only 6.89% of participants have no formal performance measurement. A comparison of the means used to evaluate the performance of the internal audit function reveals hardly any differences between audit functions with a high value contribution and the other audit functions. The greatest differences are found in the ratio “budget to actual audit hours,” which is only used in 38.55% of the audit functions with a higher score for their added value. In contrast, 45.83% of the audit functions with less added value use this KPI.

Figure 4.2: Measures, Indicators, and KPIs Used to Evaluate the Performance of Internal Audit (Overall and High vs. Low Value Internal Audit Functions)

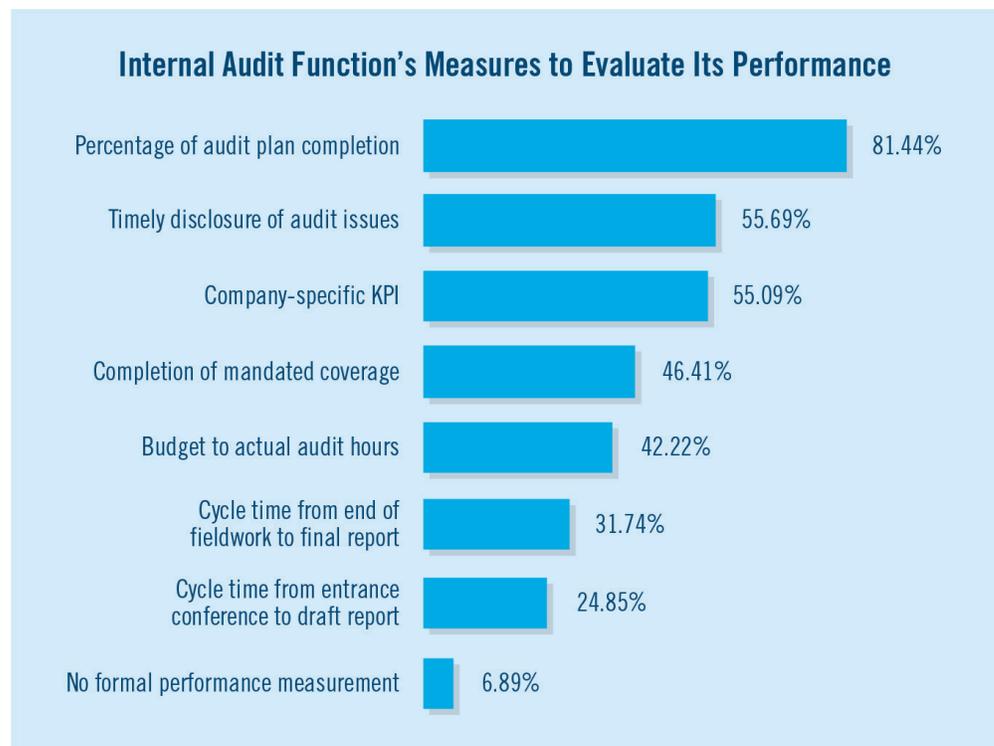
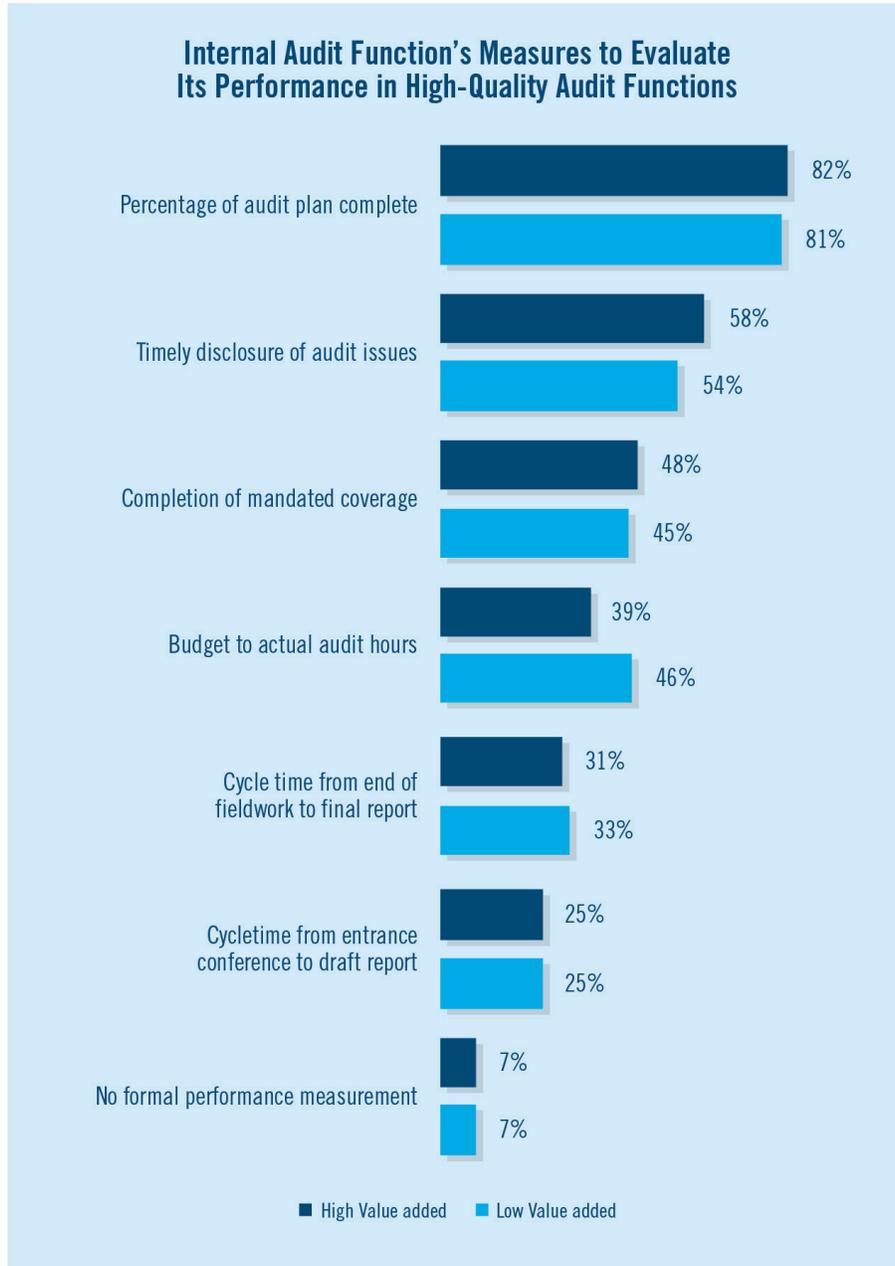


Figure 4.2: Measures, Indicators, and KPIs Used to Evaluate the Performance of Internal Audit (Overall and High vs. Low Value Internal Audit Functions) (cont.)



Top Three KPI Categories

Now we will discuss the top three KPI categories in more detail. The first KPI, “percentage of audit plan completion,” is standard for most of the internal audit functions, since it measures the completion of the intended (annual) audit plan. This is of special interest for the C-level and the audit committee, since both stakeholders have to understand and control the effectiveness of the internal audit function. This KPI helps to “measure” if the internal audit function was able to cover the previously agreed (high risk) areas of the organization with its audits. That KPI is easy to calculate and communicate. Nevertheless, because of ad hoc audits or other special request engagements, it could easily lead to a reduced percentage of audit plan completion and has to be explained to the key stakeholders. Furthermore, in a dynamic and/or complex environment, it can be counterproductive to reach 100% coverage, since the audit universe may have been altered since the initial planning phase. Thus, the CAE has to discuss and change the audit plan in line with the key stakeholders in a timely manner.

The second KPI, “timely closure of audit issues,” is also a common KPI to evaluate internal audit’s performance. Measuring the necessary time until an audit issue is closed can be understood as a measurement that covers both the quality of internal audit function findings as well as the capability of the audit client to implement the recommendations in due course, as previously agreed. Thus, this KPI addresses one of the main added values of internal audit: An improvement of the organization and its processes after an audit. Nevertheless, since the internal audit function is not directly responsible for the timely closure of audit issues (the auditee/risk owner is responsible for this), this KPI cannot be directly influenced by internal audit. Although the score of this KPI might be a good indicator for measuring the effectiveness of the internal audit function, numerous factors, especially from the auditee side, can negatively influence this KPI.

The third category covers different “company-specific KPIs.” The participants offered a broad variety of criteria, more than 180 additional KPIs (see appendix A) about multiple facets of the internal audit function altogether. We have clustered these KPIs according to different themes in line with the typical four-dimensional balanced scorecard approach. Our results show that a multidimensional reporting of different KPIs is a valid method to monitor and manage the internal audit function in a value-adding way, and also communicate the generated value to the different stakeholders. We use the balanced scorecard approach to classify the results for company-specific KPIs from our survey. Following the traditional balanced scorecard concept, we have formed four dimensions: financial and nonfinancial outcome, the stakeholder perspective, internal processes, and the learning and growth perspective:

Financial and nonfinancial outcome

There is a broad variety of potential KPIs within this dimension, focusing especially on financials and other hard facts of the internal audit function (for example, cost reductions or sales growth based on the audits, the number of findings, recommendations, or open issues). It is interesting to note that both key figures that can be directly influenced by internal audit and those that are controlled by the audited unit or management are included in this dimension. Possible examples for financial and nonfinancial outcome measures can be found in the example below.

Examples of Financial/Nonfinancial Outcome KPIs

Quantitative outcome measures: Number of audits completed to target/goal, number of internal audit reports

Cost savings and revenue improvements

Internal audit budget: Audit costs within budget, under financial budget, actual to budget

Value protection: Amount (\$\$\$) of value protected

Special audits: Completion of special audits, percentage of special or requested projects completed, non-Sarbanes-Oxley projects/non-Sarbanes-Oxley visits

Number of repeat findings

Recommendations: Number of recommendations agreed to by auditee/management, percentage of recommendations implemented, percentage of recommendations completed by original deadline

Work allocation: Audits/consultations/investigations

Stakeholder perspective

The stakeholder perspective includes the typical addressees of an internal audit report: the audit committee (chairman), the C-level management, and the audit clients. Also, the satisfaction of the regulator can be a very relevant KPI (e.g., in the regulated banking and insurance industry). Furthermore, we included those KPIs that cover the requests for support and consulting engagements by different stakeholders in this category, such as the ratio of consulting vs. assurance activities.

Examples of Stakeholder KPIs

Client/auditee satisfaction survey rating

Post-engagement survey rating

Management satisfaction survey/feedback rating

C-suite satisfaction survey/feedback rating/performance feedback from C-suite

Audit committee satisfaction survey/feedback rating/performance feedback from audit committee

Evaluations by regulators

Internal audit staff survey rating

360-degree staff development feedback

Guest auditor survey rating

Number of management requests for consulting and other services

Internal processes

The set of KPIs for internal processes includes a set of common and widely used measures — the cycle time of the audit and audit reporting, or the respect of budget constraints. Notably, multiple KPIs measure the integration of data analytics in the audit process or the number of IT audits. Other measures in this perspective focus on the communication cycle.

Examples of Internal Process KPIs

Cycle time: From closing conference to final report, from draft to final report, from entrance conference to final report, from start of fieldwork to final report

Conformance with internal audit standards: Adherence to the engagement planning standards, fieldwork standards, and reporting standards

Productivity: Projects completed within agreed-upon deadlines, effective use of resources, productivity percentage

External auditors' identification of missed findings

Data analytics: Number of issues found with data analytics, percentage of the use of data analytics in audits, level of sophistication of data analytics, costs

IT focus: Percentage of integrated IT audits, use of time, no significant audit misses

Learning and growth

The learning and growth perspective covers KPIs around the internal audit staff, qualification and certification, training, or the quality and improvement program. Typical KPIs are the percentage of internal auditors with a certification, the number of training hours spent, or the results from the last internal and external quality assessments.

Examples of Learning and Growth KPIs

Training: Level of training provided to each staff member during the year, training hours, training and development of staff/training and development plan/training hours

Certification: Level of certified staff members during the year, professional staffing, certification of employees (percentage of staff either acquired or working on certification), certifications, CPE completed, percentage of team with certifications

Quality assurance: Internal quality assurance improvement processes, which take up 35% of the overall weightage of the KPI, periodic QAR results, results of external and internal quality assessments, and undergoing and passing external peer review; successful results of external audits and regulatory exams, AMIR - Ambition Model of Internal Audit

Diversity: Diversity in the audit teams (nonfinancial team members vs. financial)

Management training ground: Training and development of talent, success in hiring talent to fill open positions, rotating internal audit personnel into operating positions

Collaboration: With other functions/business areas on company initiatives

Finally, we look at the survey questions about the most important measure/indicator/KPI for the evaluation of the internal audit functions' performance. The "percentage of audit plan completion" (44%) stacks up by far as the most prominent criterion. The "completion of mandated coverage" (16%) and "company-specific KPIs" (16%) are the runners-up. An additional analysis for the group of above average and below average participants in **figure 4.3** shows comparable results. The high-value-adding internal audit functions focus slightly more on "percentage of audit plan completion," "timely closure of audit issues," and "completion of mandated coverage."

Figure 4.3: Measures Based on Overall Evaluation for High vs. Low Value Internal Audit Functions (Overall and High vs. Low Value Internal Audit Functions)

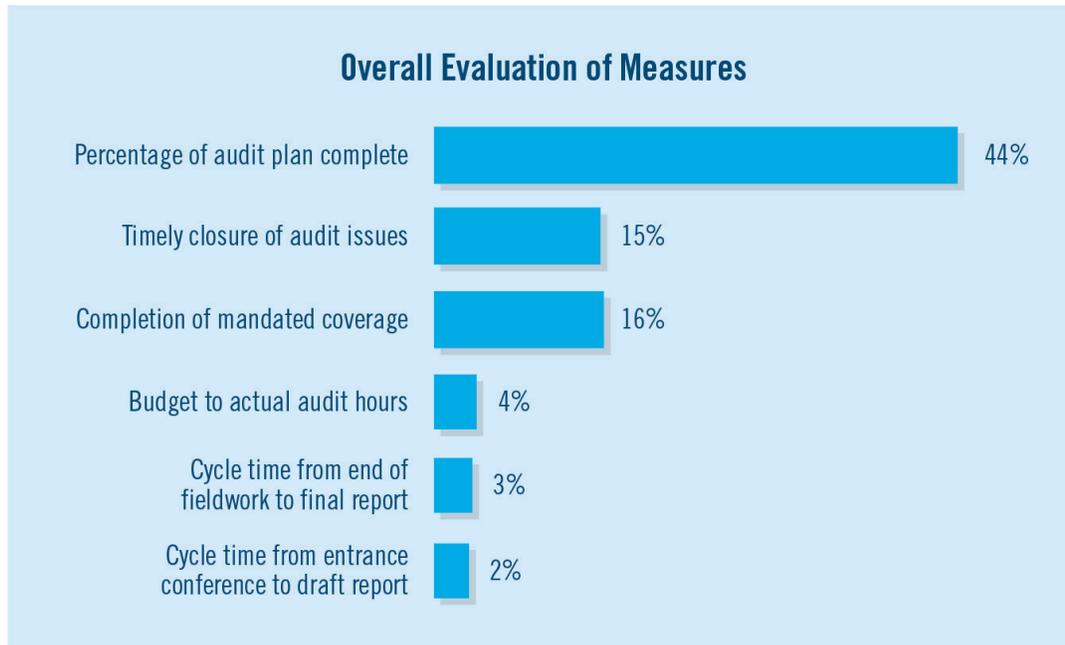
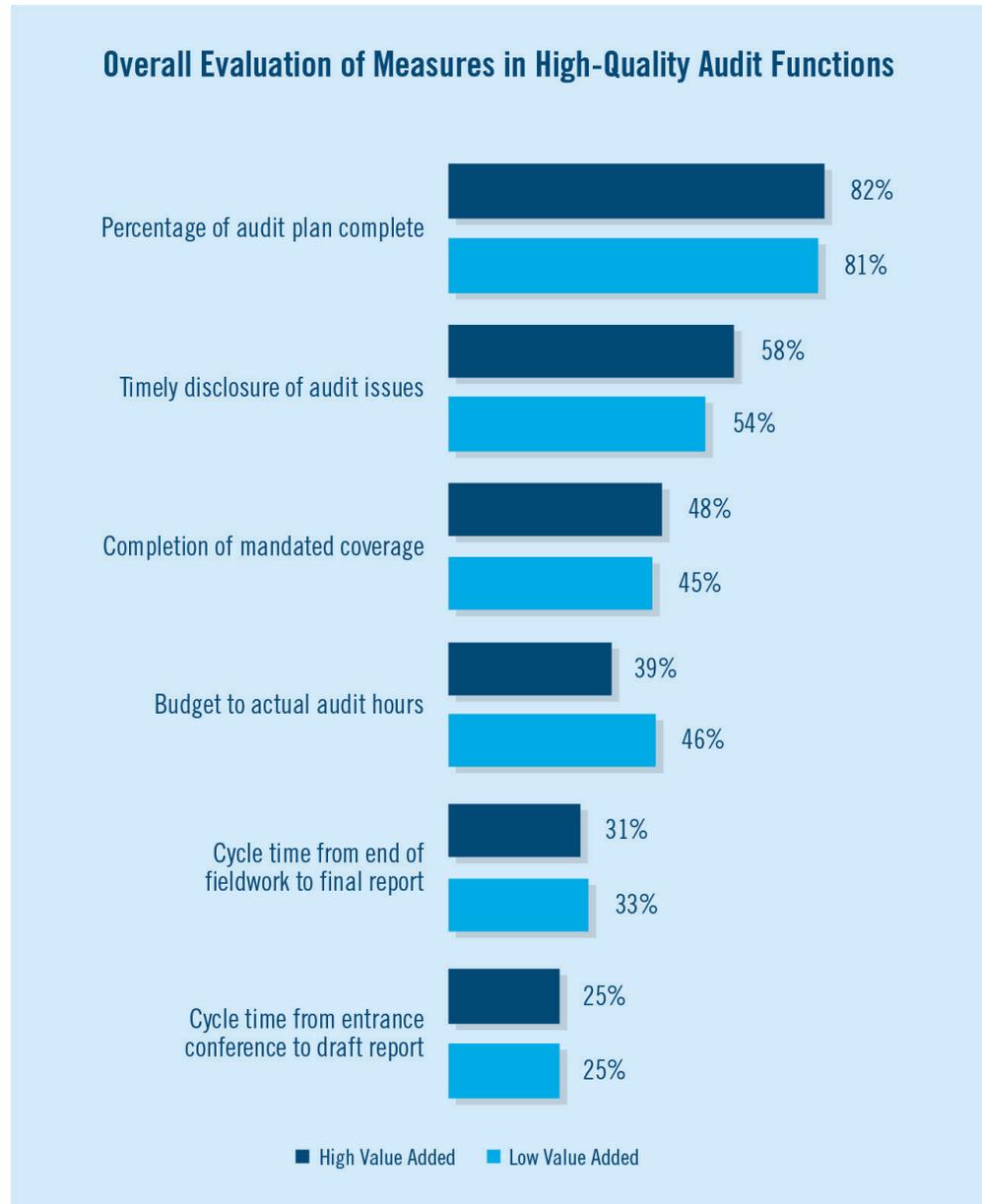


Figure 4.3: Measures Based on Overall Evaluation for High vs. Low Value Internal Audit Functions (Overall and High vs. Low Value Internal Audit Functions) (cont.)



In sum, we regard the following three criteria as core elements of any internal audit reporting package evidencing its added value:

1. Present the actual delivery of agreed projects and explain shortcomings and additional projects (ref. #1 KPI: “percentage of audit plan completion”).
2. Show the results of the follow-up tracker, that is, the status of timely completion of audit observations (ref. #2 KPI: “timely closure of audit issues”) and escalate matters, if first and second line management do not deliver as agreed/expected.
3. Report major issues and findings as the most important company-specific KPI.

After presenting the possible approaches to define and measure internal audit's added value, we now focus on the communication of the added value.

Chapter 5

Communicating the Value

Typically, the CAE reports to senior management (C-level) and the audit committee through summarized annual and periodic status reports. These reports provide the audit committee/board with material information about the performance and value of internal audit and can help the board perform its oversight function. In this context, the interview results clearly indicate that the CAE and all internal auditors need effective direct communication channels to the key stakeholders. Presenting the results and value of the internal audit function's work helps build trust and may strengthen its image and reputation throughout the organization.

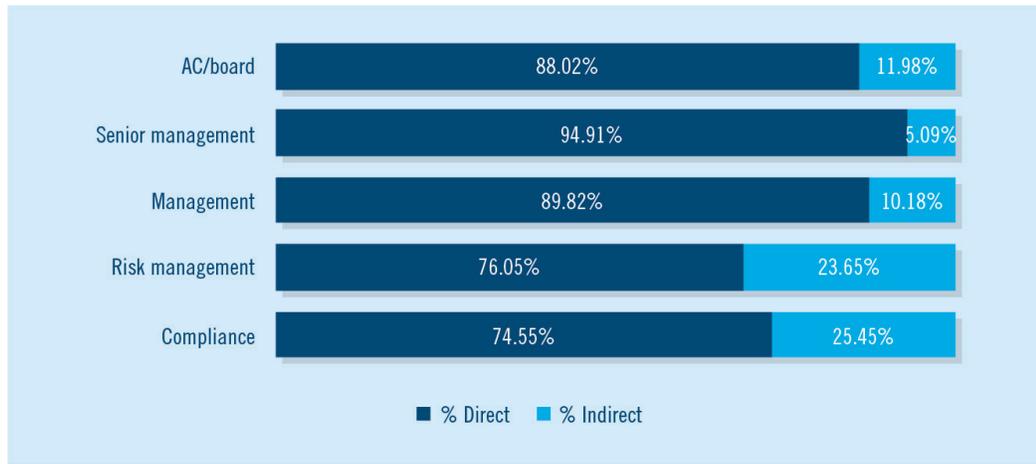
The annual report should address the question of achieving the original agreed annual audit plan and explain any additions and deviations. By providing a progress report on the status of observations and actions taken to date to address identified issues, internal audit can demonstrate that it has implemented an appropriate and effective follow-up process.

With regard to audit planning for the coming period, both the methods of risk-oriented planning and the sequence and results of the planning process and the approval of the plan can be reported. The interviewees described the benefits of direct personal communication channels to the audit committee and senior management as they strengthen the independence of the internal audit function and allow the CAE to directly address critical issues. Furthermore, those meetings are also a good opportunity to present information about the internal audit function's quality improvement program (IIA Standard 1300) or the results of the internal and/or external quality assessment (IIA Standards 1311 and 1312).

Direct Communication of Value

Survey and interview results show that the added value of internal audit can be made clear through direct communication between the CAE and key stakeholder groups. The direct contact with both senior management and the audit committee provides the internal audit function with the opportunity to demonstrate and discuss its value performance and establish a relationship built on trust (see **figure 5.1**). The survey results indicate that especially for the key stakeholders — audit committee (88.02%) and senior management (94.91%) — the direct communication dominates the practical discussion. For communication with (lower-level) management or the second line functions — “risk management” and “compliance” — the results show between 75% and 90% direct communication.

Figure 5.1: Communicating Value to Various Stakeholders



Criteria to Evaluate the Internal Audit Function

The question about the most important evaluation criteria for internal audit work shows further important findings (see **figure 5.2**). In particular, the satisfaction of the audit committee and senior management is of the highest importance. While this may seem trivial at first glance, it is important to bear in mind the extent to which each internal audit activity is actually geared to achieve the necessary stakeholder satisfaction.

Another very important criterion is the reputation or image of internal audit within the organization. The audit client satisfaction survey after each audit may provide helpful pointers. More than 72% of the survey participants agree with this criterion. From this, it can also be concluded how important the “perception/image” of internal audit is within the company. This objective can be achieved not only through compliance with The IIA’s Code of Ethics and the *International Standards for the Professional Practice of Internal Auditing*, but also with a comprehensive audit process and qualified auditors (and, of course, through the generated findings, recommendations, advice, and additional insights).

A comparison of the criteria used to evaluate the work of internal audit shows that audit functions with above-average added value consider other criteria to be important than do audit functions with lower levels of added value. The most important criteria for the high-quality audit functions are reputation within the company (70.48%), competence (68.07%), and coverage (56.0%). Audit functions with lower value added, on the other hand, consider competence the most important criterion (70.5%), followed by reputation (68.1%) and the opinion of the audited unit (56.0%).

Figure 5.2: Criteria for Evaluating the Work (Overall and Top Seven for High vs. Low Value Internal Audit Functions)

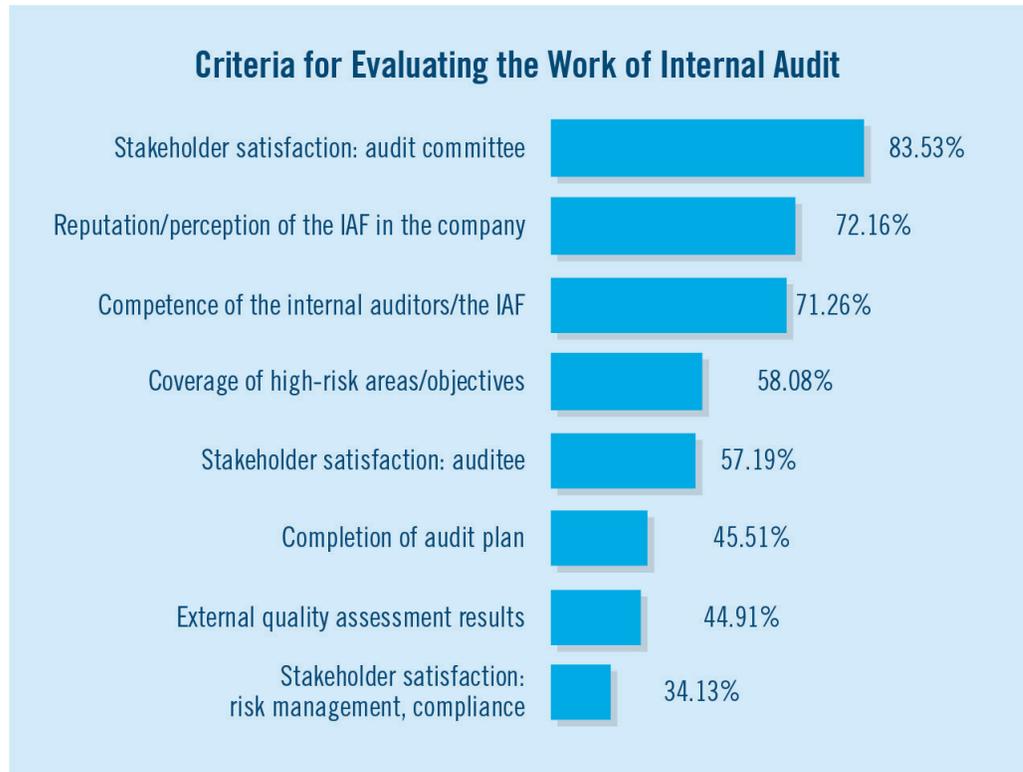
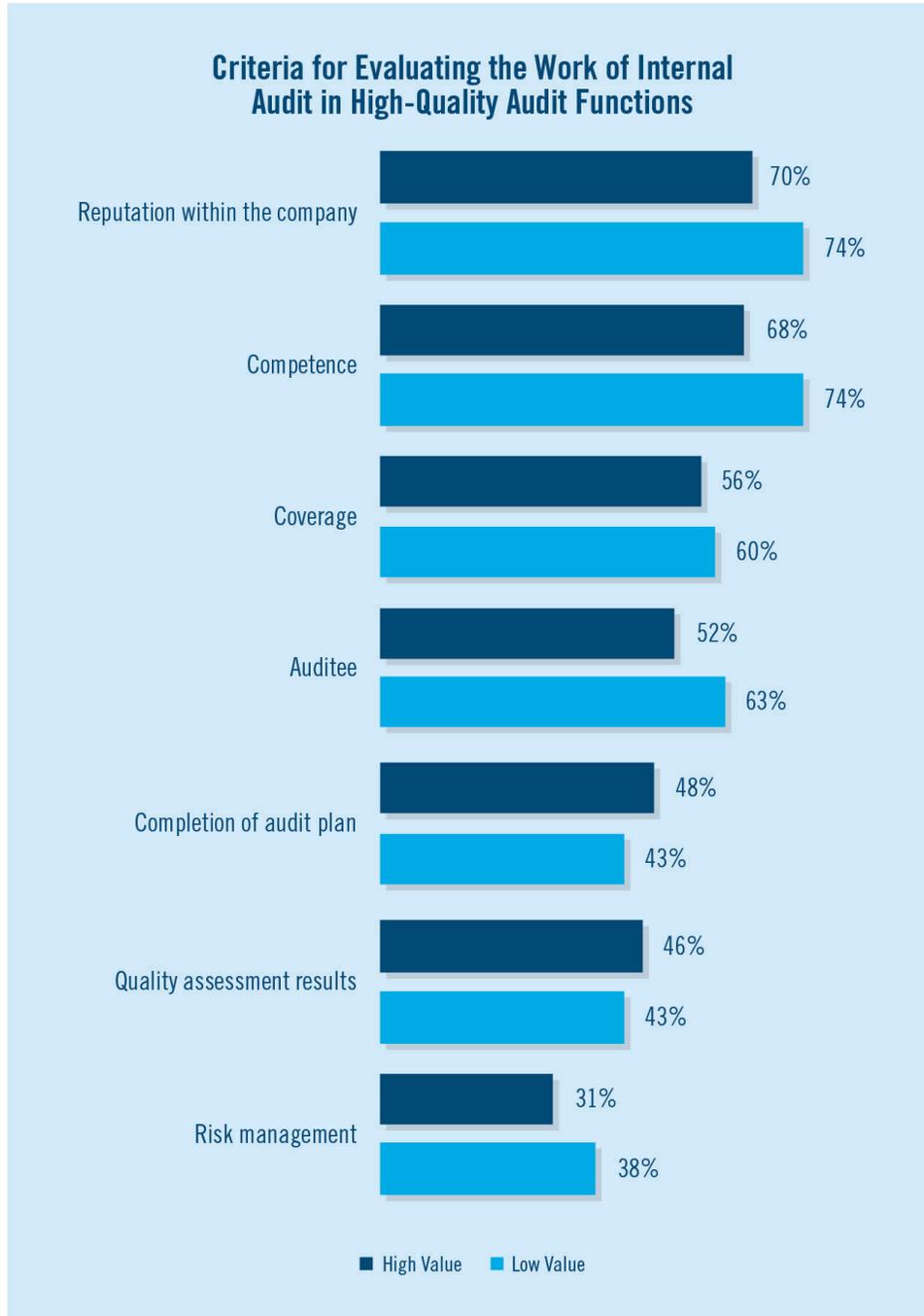


Figure 5.2: Criteria for Evaluating the Work (Overall and Top Seven for High vs. Low Value Internal Audit Functions)



Furthermore, we analyzed which specific practices are crucial for high-value internal audit functions. The following lists represents the top seven practices:

1. Reputation
2. Competence
3. Coverage
4. Auditee satisfaction
5. Completion of audit plan
6. Quality assessment results
7. Risk management

A good/positive reputation and a high level of competence are the two main success factors for high-value internal audit functions.

Chapter 6

Conclusion and Overall Best Practices

The analyses of the interviews and survey data help us identify a series of suggestions that can support internal audit functions when seeking to heighten the perceived added value within their organizations. Based on the results from the previous chapters, we suggest the following four-step approach:

1. Clarify the expected added value with key stakeholders.

Both the interviews and the survey results indicate that a comprehensive understanding of the “expected added value” is a significant condition and driver for the successful production and perception of added value. It is therefore of particular importance for the internal audit function to know and understand the expected added value from senior management and the audit committee and to align the internal audit function with these expectations. A strong and trusting relationship based on an effective communication process and a continuous exchange with these key stakeholders largely set the starting point for a successful value creation.

The internal audit charter is an excellent instrument to guarantee alignment. The expected added value comprises both the various assurance areas (GRC) and the possible consulting/advisory function of internal audit. However, it is possible the senior management and the audit committee would like to see additional areas of responsibility handled by the internal audit function. In those cases, the CAE should mindfully assess what can be done and to what extent internal audit can contribute without jeopardizing independence and objectivity. Of course, it is also possible that stakeholders may want to focus exclusively on assurance activities, which is why consulting engagements, for example, are not anchored in the internal audit charter. That may be for very good reasons (for example, in cases of serious breaches with laws and regulations or internal standards).

It is crucial for the successful and value-adding internal audit function to maintain the support of the audit committee and senior management. It is possible that some key stakeholders do not see the value and need for a strong internal audit function or fully understand what internal audit actually does.

2. Define and align the added value within the internal audit function.

Based on the expectations of senior management and the audit committee, it is important that the internal audit function aligns all activities and its own understanding of the added value with the needs of the key stakeholders. As mentioned before, the internal audit charter serves as one possible way to define and document the value proposition of internal audit. Other aspects of the value might be determined by the annual audit plan, the rules of procedure and the audit manual, etc. Those expectations must be met in the audit practice so that all activities and the overall audit process is always in line with the expected value

of internal audit. Thus, the internal audit manual can help clarify the position, processes, audit methods, and so forth.

For example, if senior management and the audit committee expect a strong focus on assurance, internal audit should align the audit plan with this specific demand. All activities, such as the risk-based audit plan, the audit process, and the technical and personnel resources, must therefore be geared to the previously defined and agreed objectives. It is important to regularly check the alignment of the internal audit activities with the objectives. This process can also be included in internal audit's quality assessment and improvement plan. The definition and clarification of the internal audit functions' added value serve as motivational and coordination factors too. Finally, each auditor can align all of his or her activities with the agreed value concept in the specific organizational setting.

3. Create a transparent measurement model for the internal audit function.

The objective of KPIs for the internal audit function is to provide information about the input, throughput, and output of internal audit in an aggregated form. KPIs allow the CAE, the internal auditors in the function, and the key stakeholders to monitor and evaluate the performance of the internal audit function in a simple way. Furthermore, KPIs can initiate a continuous improvement process, since low values of an important KPI might indicate room for improvement. Nevertheless, it is very important that the KPIs are always aligned with the corporate strategy and objectives and with the internal audit objectives. Otherwise, the CAE and the key stakeholders cannot evaluate and guarantee that the internal audit function is really creating an additional value and the spent resources are efficiently and effectively allocated.

Our results suggest three criteria as must-haves: present the actual delivery of agreed audits, thereby explaining shortcomings and additional projects ("percentage of audit plan completion"), show the results of the follow-up tracker, that is, the status of timely completion of audit observations ("timely closure of audit issues"), and report major issues and findings as the most important company-specific KPI. Based on the results, a balanced scorecard approach can be helpful for classifying and ordering the specific KPIs. Finally, internal audit should be very selective with the chosen KPIs to guarantee an optimal measurement model.

4. Communicate the added value inside and outside the internal audit function.

Finally, the added value of internal audit has to be recognized by the key stakeholders in the organization. If the added value is acknowledged and recognized, the communication and mutual understanding of internal audit activities and the need to have a good internal audit function become clearer. Thus, the internal audit function should be collaborative and communicate as a trusted advisor, since the overall objective of all stakeholders is the same: Helping the organization to achieve its objectives and reducing all existing and potential risks. This scenario, of course, demands a high-quality internal audit function with excellent internal auditors, a transparent internal audit process, and the necessary resources. It is crucial to maintain trustful (no finger pointing) communication

with the audit clients and all other stakeholders. When reputation is damaged, it is very hard for internal auditors to restore their initial image. Thus, they should always communicate with the highest level of respect.

If the overall approach and added value of the internal audit function become the reality for the key stakeholders, the perception of the internal audit function changes positively. Finally, internal auditors may be seen as trusted advisors and be exposed to new topics and risk areas that truly matter. In doing so, internal auditors must stand tall, get out of their comfort zone, and become pioneers.

Our Conclusion: Become a Value Driver

Our results suggest three different roles that internal audit can take on in our proposed maturity model. We distinguish the role models as GRC partner, trusted advisor, and value driver. Our conclusion is that the main objective is to be a value driver in the organization. The value driver overcomes the traditional focus of a “watch dog” internal audit function with a strong focus on assurance and contributes to what truly matters in the organization. The value driver gives advice and creates value to uncommon and/or new activities, approaches, and tools. The value driver adapts to the circumstances at the speed of risk (Chambers, 2019).

The present challenges caused by COVID-19³ are a moment of truth for mankind, including the internal audit community. We will see what internal audit can contribute when organizations focus on what is essential to survive. We are optimistic. New patterns can emerge when ending non-value-adding institutional routines. We are all in the pioneering zone now. Aspiring to become a value driver might help and provide orientation for internal auditors to be ambitious and courageous, and become “stars in the darkness.”⁴ Internal audit is well positioned to do so. This type of an internal audit function is able to work on all levels in the organization, act in and across functional silos, and provide a unique perspective of the organization and its challenges and opportunities. Through this approach, internal audit can earn a seat at the table and, more importantly, offer unique contributions. Thus, the value driver offers unique insights and foresight and can contribute to discussions about corporate culture, corporate strategy, operations, decision making, and so forth. The value driver is presently aspirational for most internal audit functions.

Putting these best practices in place will help internal auditors address the “so what” question. When starting with and permanently seeking alignment with key stakeholders, it will become clear(er) what the internal audit function in the respective organization does and what its contribution is all about. In the days of COVID-19, it may be a smart move for internal auditors to simply ask senior management, “How can internal audit help the organization during the crisis?” That conversation may lead to fresh perspectives and a new focus on the activities. Shared goals, shared vision, and shared knowledge are key ingredients of a successful value-adding internal audit function.

³ Please see COVID-19 on Wikipedia. For example, <https://de.wikipedia.org/wiki/COVID-19>, accessed on April 1, 2020.

⁴ Martin Luther King Jr., “Only in the darkness can you see the stars.”

Appendix

Detailed Participant Information

Interview Participants

Semi-structured interviews were conducted with 11 CAEs (or internal audit directors) over the course of eight weeks. The figure below provides basic demographic information about the interviewees and their companies. The respondents come from a diverse set of organizations, and the size and scope of the internal audit functions at these organizations vary as well. However, each is an active member of The IIA, and their organizations are recognized as having effective internal audit functions. Therefore, we look to these CAEs to provide best practice recommendations and lessons learned that can be helpful to other internal auditors and their organizations.

Interviewee Demographics and Identified Innovations

Company Identifier	Industry	Interviewee Role	Geographic Scope	Public/Private	IA Size
C1	Gas	CAE and CRO	South America	Public	4
C2	Governmental	Head of IA	North America	Governmental	8
C3	Manufacturing	CAE	Global	Public	4
C4	Manufacturing	Head of IA	Global	Public	40
C5	Infrastructure	CAE	Global	Public	38
C6	Media/Industry	Head of Audit	Global	Public	45
C7	Manufacturing	Head of IA	Global	Public	5
C8	Financial	Head of IA	Global	Public	220
C9	Manufacturing	CAE	Global	Public	57
C10	Trade	CAE	Global	Public	30
C11	Manufacturing	CAE	Global	Public	100

In total, the sample obtained provides a diverse view of internal audit functions across the world. It is suitable for a detailed study of how internal audit functions define and measure the value of internal audit in their organizations.

Survey Participants

In September 2019, the Internal Audit Foundation sent an email to global IIA chapters to introduce our study and invited them to circulate a link to our online survey to their members. The survey was open for approximately one month and a total of 336 individuals responded. Each participant answered questions about the added value, as well as control questions about their organization and their own position. Thus, we deem this sample to be sufficient for the purposes of this study. In total, the sample obtained provides a diverse view of internal audit functions across North America, Europe, and the rest of the world at various maturity levels. It is suitable for a study of how internal audit functions define, measure, and communicate the added value in their organizations.

Position of Survey Participants	Percentage
Chief audit executive (CAE) or head of internal audit	77.84%
Director or senior manager (level below CAE)	12.43%
Manager (level reporting to director or CAE)	6.22%
Audit staff (those who perform audits)	3.51%
Total	100.00%

Total Number of Full-Time Equivalents in the Organization	Percentage
More than 50,000	2.69%
10,001 to 50,000	18.56%
5,001 to 10,000	10.78%
1,501 to 5,000	28.14%
501 to 1,500	20.06%
500 or fewer	19.76%
Total	100.00%

Governance Type of Participating Organizations	Percentage
Publicly traded	32.04%
Privately held	26.95%
Public sector - local	10.18%
Public sector - state/province	9.88%
Nonprofit	8.08%
Public sector - federal/national	7.49%
Non- or inter-governmental organization	2.40%
None of the above	2.99%

Industry Type of Participating Organizations

Industry	Percentage
Agriculture, forestry, fishing, and hunting	2.69%
Construction	2.10%
Gaming	1.20%
Hospitality and amusement parks	0.30%
Educational services – colleges and universities	3.29%
Educational services – other	1.50%
Financial services – asset management	1.80%
Financial services – banking	15.27%
Financial services – credit union	2.10%
Financial services – insurance	6.29%
Financial services – other	5.09%
Healthcare and social services – hospitality	5.09%
Healthcare and social services – insurance	1.50%
Healthcare and social services – nursing	1.20%
Healthcare and social services – other	2.69%
Information technology	2.69%
Manufacturing	10.18%
Mining, quarrying, and oil and gas extraction	3.29%
Professional services firms	2.10%
Wholesale and retail trade	4.79%
Scientific and technology services	0.30%
Transportation and warehousing	3.89%
Utilities	2.69%
Other	17.96%
Total	100.00%

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