

Voice of the Customer

Stakeholders' Messages for Internal Audit



A CBOK Stakeholder Report

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Executive Summary

Internal audit has a unique and critical role to fill in organizational governance. In fulfilling this role, internal auditors work with a wide variety of stakeholders in their organizations. The focus of this report is on board members and members of the executive team of organizations that have internal audit functions. While there are other types of stakeholders, these are the ones that most directly affect the work of internal audit.

The stakeholder study was not designed to measure whether there is a gap between what stakeholders expect from internal audit and whether these expectations are being met. Rather, it focused on the recommendations from stakeholders on the best practices internal auditors should consider in their quest to continually improve performance and bring value to their organizations.

The stakeholders' key messages to internal auditors are:

- Know your organization's mission, strategy, objectives, and risks. Effectiveness of internal audit continually comes back around to this foundation.
- Assurance work is highly valued. While other tasks and projects performed by internal auditors may be value adding, they should not be done at the expense of assurance work.
- Conformance with The IIA's *International Standards for the Professional Practice of Internal Auditing* is expected.
- Assurance work is most valuable when it is aligned with the strategic risks of the organization. Use the organization's strategy to drive risk assessment and the selection of assurance work.
- Advisory work is highly desired, with areas related to risk requested most frequently.
- Coordinate with functions in the second line of defense. Rely on their assurance work once they have been proven to be objective and reliable.

- Internal audit must be structured properly in the organization.
- Build relationships with management and board members. Relationships must be based on mutual trust and respect.
- Communicate your observations and opinions frequently. Do not rely solely on written communication, but have frequent face-to-face meetings and discussions.

1. Know the Business of Your Organization

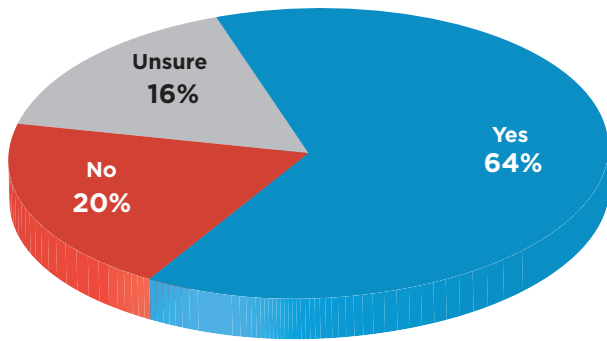
Internal auditors must understand the mission, strategy, and objectives of their organizations. This was a central, overriding message from all categories of stakeholders. Whether they are board members or part of executive management, stakeholders are primarily focused on the organization's success in accomplishing its mission. Naturally, they want to see internal auditors looking at their role in the same way, concentrating on how they can help the organization be successful. For internal auditors this means not only having knowledge of the organization's strategy but also being able to get inside that strategy and understand how it drives the activities of the organization, what can disrupt it, and what is needed for the strategy to be accomplished. Internal auditors need to be masters of the business of their organizations.

The CBOK 2015 practitioner study found that 57% of internal auditors stated their audit plans align with the strategic plans of their organizations. This means that for 43% of the internal auditors, their plans are not aligned.

Stakeholders were asked whether internal audit should have a more active role in assessing and evaluating the organization's strategic risks. Nearly two-thirds (64%) say they want internal audit to be more active in strategic risks, with only 1 out of 5 disagreeing (see **exhibit 1**).

There are always competing demands on internal audit's resources, but the key message from stakeholders is that internal auditors must focus their efforts based on the organization's strategy. A CEO from South Africa echoed

Exhibit 1 Should Internal Audit Have a More Active Role in an Organization’s Strategic Risks?



Note: Q16: Do you believe internal audit should have a more active role in connection with assessing and evaluating the organization’s strategic risks? n = 859.

the comments of many stakeholders, stating that internal auditors should be “starting their process with our organizational strategy and objectives, identifying the risks and basing their audit plans on this.”

This does not mean internal audit will normally be involved in developing or challenging the strategy. As the CEO from a French organization stated, “Internal audit may question the relevance of certain strategic objectives but is not directly involved in determining the strategy.” Instead, internal audit would plan its activities to focus on those aspects of the organization that directly support its strategy and objectives.

This requires internal auditors to relentlessly ground themselves in understanding their business. Stakeholders expect it to drive internal audit’s actions. As one board member from Singapore stated, “If the [internal auditors] understand the business well, they can balance their priorities.”

“[Internal audit] supports by enhancing the existence of controls against the risks that hinder the organization to achieve its strategic and operational goals.”
—Board Member, Turkey

ACTION ITEMS FOR INTERNAL AUDITORS



- ✓ Become masters in knowing the mission, strategy, objectives, and risks of your business.
- ✓ Help stakeholders recognize that you understand the business, framing your communication with them within the context of strategy and objectives.

2. Assurance is Assumed

Internal auditing has a long tradition of providing assurance to stakeholders that risks related to financial, operating, and compliance objectives are being properly managed. Internal auditors have also been encouraged to branch out from this traditional assurance role into other advisory and consulting roles. One board member in the United States, when asked which has higher priority, assurance or advisory/consulting work, responded “Both.” Stakeholders understand that internal audit can operate in both areas, and most would agree that the shift away from a sole focus on assurance is positive.

However, this does not mean stakeholders want internal audit to abandon assurance. To the contrary, the interviews conducted during this study indicate the opposite: stakeholders expect internal audit to provide assurance—and do it with excellence. When asked to comment on the balance between assurance and advisory efforts, the comments included:

“Assurance activities would still go first, and if there are sufficient resources, the remaining resource will go for consulting.”

—Board Member, Taiwan

“Assurance is essential and consulting is nice to have, but should be second in priority.”

—Board Member, United States

“First of all, priorities should be identified. I think assurance activities come first.”

—Executive Management, Turkey

Variance among stakeholders was mostly from the type and extent of advisory services internal audit should provide, not whether assurance is primary. When asked for a specific input on the balance between assurance and advisory work, stakeholders usually volunteered that advisory work, if provided, should fall within the range of 20% to 50% of effort.

“The balance should depend on the current strategy of the company, the level of internal control, system maturity, stability of the business, and other factors.”

—Board Member, Russia

The level of advisory work varies by organization. Stakeholders recognize this and identified a number of factors that should drive the differences. First is the maturity of the organization and its location. As a board member from an organization in China stated, the level of advisory work “depends on the maturity of the company as well as the country [in which] it is operating.” Less mature organizations and those operating in developing countries may have greater need of assurance over the foundational aspects of the organization’s activities.

Second is competence of the internal audit function. Internal audit needs to be seen as being able to deliver insight and value through advisory or consulting work. There are skeptics among stakeholders that internal audit has this competency.

Third, many stakeholders do not see this as an “either/or” situation. When internal auditors provide assurance work, they can also provide insight and advice because of that work. As the chief operating officer (COO) of an organization in the United States said, “...they have done a good job providing consultative recommendations through an assurance review.” It is common for internal audit to provide recommendations as the result of assurance work; for many, this is a form of advisory or consulting work.

“Providing consulting services to business operations is a ‘nice to have,’ but internal auditors don’t typically have enough experience to provide deep consulting expertise.”

—Board Member, United States

“It comes with understanding the business. Some CAEs [chief audit executives] don’t have this competency to provide consulting services.”

—Board Member, Singapore

Fourth, some stakeholders are concerned that being overly focused on advisory work will detract from internal audit’s primary focus on assurance. Advisory work can be challenging, rewarding, and an easy way to exhibit value from internal audit—and internal audit can be very, very good at providing it. But with limited resources, an increase in the focus on advisory work could result in insufficient assurance work.

Stakeholders expressed this view in a number of ways:

“One of the concerns I have is for internal auditors to be consumed with special projects, which takes their attention away from their first priority (assurance).”

—Board Member, United States

“The organization must be able to call upon internal audit and benefit from its expertise without denaturing its ‘soul.’ In certain consulting engagements, there is a risk of internal audit becoming a ‘low cost’ subcontractor. Just because you are dealing with a reliable and trustworthy person, it doesn’t mean that his expertise should be diverted and exploited at will.”

—Board Member, France

Last, stakeholders want to keep internal audit independent so it can perform its assurance work. As one stakeholder stated, “Consulting services should not lead to distorting the internal audit department’s role and leading to its loss of independence.”

ACTION ITEMS FOR INTERNAL AUDITORS



- ✓ Stakeholders view assurance as essential. Balance your work to reflect this.
- ✓ Pursue advisory or consulting work where you have the competency, capacity, and support from stakeholders.

3. Best Practices When Providing Assurance

While nearly all stakeholders value assurance work by internal audit, they have definitive preferences as to how that work should be done to have the most value. As noted earlier, stakeholders expect internal audit to understand the organization well. When asked how internal audit could best improve its role in responding to strategic risks, incorporating a focus on strategic risks during assurance work was the most recommended option (see **exhibit 2**).

To get “more strategic,” the first approach should be to ensure assurance work is closely aligned to the strategic risks of the organization. As the chief financial officer (CFO) of an Italian company stated, “Providing assurance over [an] organization and [its] processes’ ability to

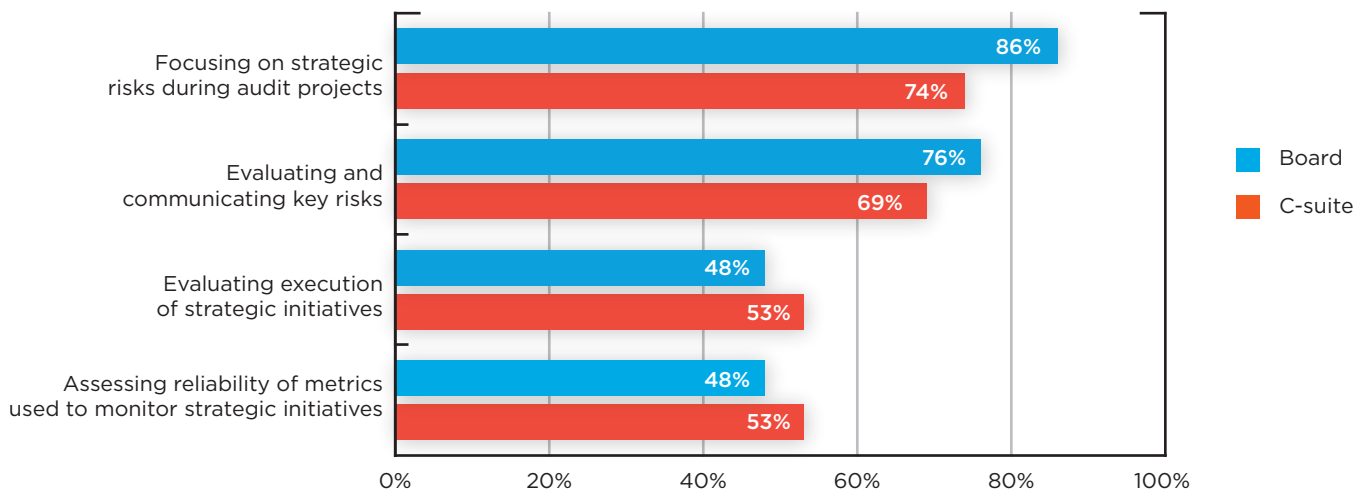
support strategy” is a key approach to supporting the organization’s strategic goals.

This does not mean internal audit ignores financial, operational, or compliance risks. In almost all cases, these risks are directly linked to the organization’s strategy. The key is being able to link these “traditional” risk areas to strategy. Through this process, it may not be possible to link certain existing assurance efforts to the organization’s strategy or objectives. In this case, internal audit should carefully consider the value of that assurance work. Performing work because it has always been done, is expected, is comfortable, or is on the rotation schedule is not a way to ensure internal audit is supporting the organization’s strategy and objectives.

“Internal auditors need to be able to structure their annual plan to link the corporate strategy to their efforts/accomplishments. It is important to identify weaknesses and link them to the key strategy.”
—Compliance Executive, Spain

The study also raised the question of whether internal audit should focus on current risks or future risks. As one may expect, there were varying opinions. Some stakeholders have a strong focus on current risks due to their

Exhibit 2 Avenues for Internal Audit to Improve Its Role in Responding to Strategic Risks



Note: Q17: Please designate which of the following are avenues for internal audit to improve its role in assessing/responding to strategic risks facing your organization. n = 553.

importance. A CFO in the United States expressed it this way, “Because technology is changing so much, we need to be focused on things that are happening right now. Ideally, [internal audit] can be looking at the future, but we can’t get there just yet.” Many others, however, recognize that future risks cannot be sidelined because they will soon be current risks. A chief executive officer (CEO) from South Africa commented, “Risks are always changing...Our business is such that the future risks are massive and have to be identified.”

The distinction between current and future risks is not always clear, and focusing on the future cannot be at the expense of addressing current risks. As a board member of a French company said, “When you are talking of the future, you are in the present. So, we really can’t separate future and present risks as there is a permanent link between them.”

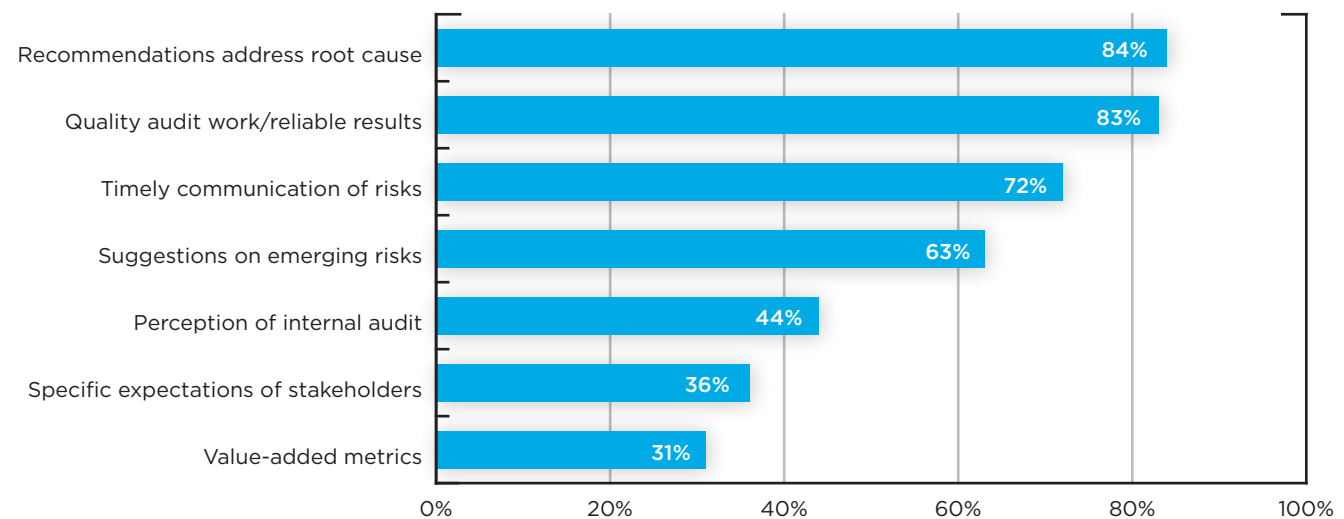
There is another ingredient to providing assurance services to stakeholders beyond focusing on the right risks. Internal auditors also need to perform the work with excellence. Stakeholders were asked on what basis they evaluated the performance of internal audit. High on the list of attributes was the quality of the audit work (see **exhibit 3**). Flashy topics and pretty charts are nice, but the fundamental work underpinning the assurance must be sound.

Internal auditors look to The IIA’s International Professional Practices Framework (IPPF), which includes the *Standards* and other guidance. Stakeholders were asked whether they have knowledge of the *Standards* and, if so, whether they believe it has value for the performance of internal auditing. Roughly half (53%) know of the *Standards*, and nearly all (94%) of these believe there is value in *Standards* conformance. As a board member in the United States stated, “Conformance to [the] *Standards* is expected and must occur.”

The practitioner study found that only 54% of respondents conform with all of the *Standards*. For the nearly half of internal auditors who do not fully conform, they may find themselves out of sync with the expectations of their stakeholders.

The good news from the study is that stakeholders give high marks to internal audit performance on fundamentals of assurance work, such as addressing significant areas, keeping up to date on the industry, and assessing traditional audit areas like finance, operations, and compliance (see **exhibit 4**). This view of stakeholders provides a good foundation for internal auditors to leverage their reputation for quality into other areas in which they can add value.

Exhibit 3 Factors Stakeholders Consider in Assessing Internal Audit Performance



Note: Q24: What factors do you, as a stakeholder, consider when you assess and measure the performance of internal audit? n = 939.

Exhibit 4 Attributes of Internal Audit as Assessed by Stakeholders



Note: Q18: Please provide a response to each of the following statements according to the following scale: Strongly Agree, Agree, Disagree, Strongly Disagree, Don't Know. Percentage shown for those that indicated Strongly Agree and Agree. $n = 960$.

ACTION ITEMS FOR INTERNAL AUDITORS



- ✓ Explicitly consider both current and future risks when planning assurance work. The balance of focus depends on the specifics of the organization and its environment.
- ✓ Maintain the quality of assurance work to provide license for internal audit to provide value in other areas.

4. Building on Assurance

Stakeholders want internal audit to provide advisory work where it does not interfere with their assurance work. Stakeholders were asked where internal auditors should focus their efforts beyond assurance. The answers supported by more than 50% of stakeholders are shown in **exhibit 5**. Four of these five areas focus on risk and circumstances that affect changes in risk.

Similarly, stakeholders were asked in what areas internal audit adds the most value. The only answer for which

more than half attributed high value was “assistance in managing risk.” The message from stakeholders is clear—when looking beyond assurance, they believe internal audit can be most valuable to organizations by being involved in risk identification and management.

“Internal audit is in a unique position to engage and educate on risk and control—and improve the culture of the organization.”

—Board Member, Australia

Interviews with stakeholders provided the same guidance. When asked how internal audit can help improve the culture of an organization, a board member from Germany stated, “Promote a culture of discussion/risk awareness.” Similarly, a board member in France said, “Internal audit can certainly contribute to improving the culture of the organization by helping to raise awareness... it helps to make managers aware of risks.”

Exhibit 5 Areas for Internal Audit to Address Beyond Assurance



Note: Q10 to Q13: Which of the following areas should, beyond assurance, be in scope for internal audit? $n = 836$.

ACTION ITEMS FOR INTERNAL AUDITORS



- ✓ Consider how best to focus advisory activities on risk identification and management.
- ✓ Take best advantage of internal audit's unique role to bring increased understanding of risk and risk management to the entire organization.

5. Coordinate with the Second Line of Defense

The three lines of defense framework is useful for understanding the roles and responsibilities of various parties that contribute to the management of risks (see IIA's related position paper).^{*} Many larger organizations have established functions that operate as part of the second line of defense (e.g., compliance and risk management). To stakeholders, the relationships between the second line functions and internal audit may not always be clear. One thing that is clear, however, is stakeholders expect internal audit to work closely with these second lines of

defense. The CFO of a Brazilian company put it this way, "In general, [internal audit and the second line of defense functions] should be clearly related and interconnected. It would be disastrous if these elements take different paths with different visions."

Most stakeholders expect internal audit to communicate extensively with these functions and coordinate where possible. "Audit fatigue" affects many organizations when multiple functions are reviewing and assessing the same activities within the company. In addition, boards then have to decipher reports from multiple functions that seemingly cover the same material. Some organizations have adopted an integrated approach. A CFO in South Africa said, "[Organization] has adopted the three lines of defense model and internal audit does work with other assurance providers. We have an integrated approach where we sit and plan in order to rely on the work of others."

But cooperation is not without caution. Many stakeholders appreciate that internal audit is different from second line of defense functions. In some cases, the function is robust and well run, allowing extensive reliance in an integrated model. In other cases, reliance is inappropriate.

A general view drawn from the interviews is for internal audit to coordinate as much as possible, rely as much as possible, but only do so based on evidence that functions in the second line of defense earn that reliance. This view

^{*} IIA Position Paper, The Three Lines of Defense in Effective Risk Management and Control (Altamonte Springs, FL: The Institute of Internal Auditors), January 2013.

is summed up well by a stakeholder from Japan who said, “We should utilize existing compliance and risk management functions as much as we can. We have to assess [the] reliability of [the] report. The utilization is depending on its objectivity...”

“Risk and compliance is pretty new at our company. Internal audit shouldn’t rely on them just yet—we would like to get them there, but we need a greater level of trust in that group before we can rely on them.”

—Chief Financial Officer, United States

ACTION ITEMS FOR INTERNAL AUDITORS



- ☑ Understand clearly the work done by functions in the second line of defense.
- ☑ Coordinate as much as possible with these functions, working toward common views of risk and compliance where possible.
- ☑ Rely on assurance work done by these functions only when the objectivity and rigor of their work has been tested and verified.

6. Ingredients for Success

For internal audit to be effective, it needs to be an independent, objective function that can “think straight—talk straight,” in the words of a board member in the United States. Two critical components contribute to internal audit being able to provide the objective and independent messages in a manner that will be received.

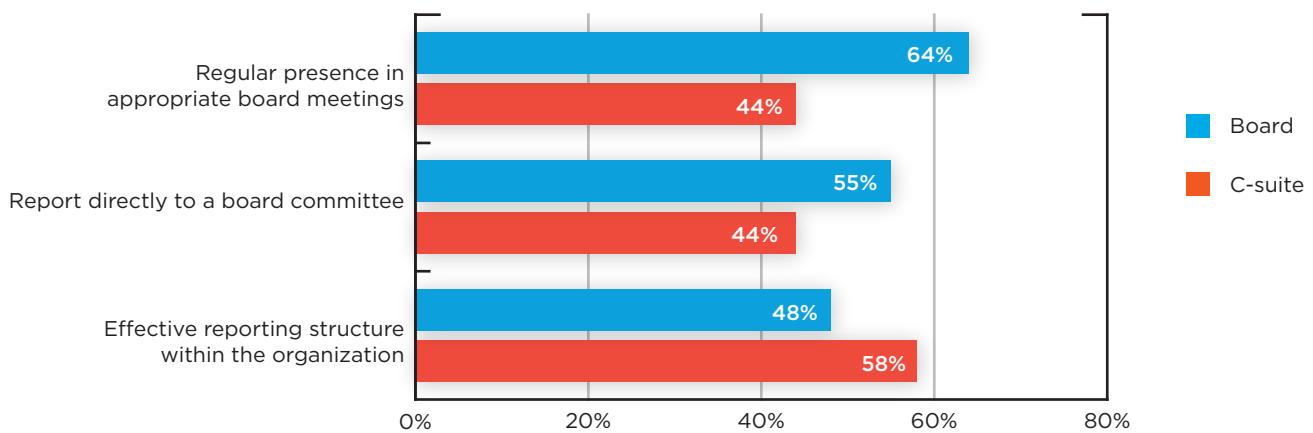
Structure

As the third line of defense in an organization, it is critical for internal audit to have direct functional reporting to the board (see **exhibit 6**). This is outlined well in the *Standards* and further described in various discussions of the three lines of defense model.

Stakeholders were asked for the best strategies for internal audit to resolve competing demands. Board members strongly support reporting directly to the board and attending the appropriate board meetings. C-suite members also support these options, although less enthusiastically, and more of them strongly support a proper reporting structure within the organization.*

* The practitioner study found that 69% of respondents had a functional reporting relationship with the board.

Exhibit 6 Best Strategies to Address Competing Demands



Note: Q9: What have you found to be the three most effective strategies for a chief audit executive to employ in order to prioritize and address competing demands in the organization? n = 917.

A key element to the effectiveness of structure, however, is for the board members and members of the C-suite to recognize that functional reporting to the board is not a passive activity. The board needs to be the primary body to engage with internal audit on developing the audit plan. It needs to be able to hear objective messages from them, not ones filtered through management. The board needs to be the primary body responsible for deciding on internal audit's resource levels and composition. It needs to drive the appointment, promotion, compensation, and removal of the CAE.

Internal auditors cannot expect every stakeholder to understand independence as outlined in the *Standards*. As one board member in The Netherlands stated, "CAE reports to the CEO, with him he prepares the audit plan." Similarly, a board member in France said, "Ultimately, it is the CEO who sets the priorities and assumes overall responsibility." For these board members, the CEO is the driver in working with internal audit, and the board watches and approves. In these two examples, the form of internal audit's reporting structure is likely less impactful than the beliefs and actions of the board members.

Relationships

Structure alone is not sufficient. There is an equally important element on which internal audit relies to be effective. "To think in a strategic fashion, the head of the internal audit department must be in constant contact with the business, able to quickly grasp the strategic changes by creating ongoing professional relationships with all key members of the company (and not just the CEO)." This quote from an interview with a stakeholder in Italy represents well the view of many stakeholders.

Relationships are critical in understanding the business and keeping up with changes. However, relationships are valuable for much more. When stakeholders were asked for the best method to resolve competing demands, the number one choice selected by 67% of all stakeholders was to build strong relationships with operational and functional leaders. A CFO from the United States said, "I think having strong relationships is very important..."

People will always have different perspectives, but compromising is easier when relationship is there."

One aspect of building and maintaining strong relationships is communication. Just less than 75% of stakeholders rated internal audit's quality and frequency of communication as very good to excellent. While this is generally positive, anything less than 100% should be considered an opportunity for improvement. In addition, a number of stakeholders emphasized communication needs to be in person, not just through documents and written messages.

"Negotiation through face-to-face meetings is the most effective strategy for CAEs...Written plans don't have the same impact."

—Chief Operating Officer, Australia

"Constant meetings and interaction are important."

—Board Member, United Arab Emirates

The advice to invest in building strong relationships comes with a caveat from the stakeholders. As a CEO in Brazil stated, "Internal audit should observe and monitor its level of relationship, not being too close or too far away." Neither weak relationships nor relationships that threaten independence are good. Balance is needed.

ACTION ITEMS FOR INTERNAL AUDITORS



- ✓ Review the reporting structure for internal audit and start the conversation with stakeholders if it is not optimal.
- ✓ Evaluate whether the behaviors of stakeholders are consistent with the reporting structure and appropriate to maintain independence.
- ✓ Consider the quality, frequency, and methods of communication with stakeholders.

Conclusion

Internal audit exists to serve its organizations and stakeholders. Understanding the needs and views of the stakeholders will help internal auditors to better fulfill their role. This report summarizes the views of internal audit stakeholders as a group. Not all organizations are alike, and not all stakeholders are alike. Each internal audit group must consider their specific situation and their specific group of stakeholders and evaluate what changes they need to make to be more valuable to their organizations.

“Realize there are competing interests between the board and management.”

—Board Member, United States

About the Authors

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STAKEHOLDER STUDY FACTS

Survey participants	1,124
Interview participants	112
Countries	23
Languages	13

STAKEHOLDER POSITIONS REPRESENTED

Board member	34%
Chief executive officer (CEO)	15%
Chief financial officer (CFO)	18%
Other C-suite	33%

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The Global Internal Audit Common Body of Knowledge (CBOK) is the world's largest ongoing study of the internal audit profession. The current study has two major components: practitioner and stakeholder. The practitioner study explores a variety of internal audit practices. The stakeholder study seeks out perspectives about internal audit performance. Surveys, interviews, and data analysis for the stakeholder project were conducted by Protiviti in partnership with IIA institutes around the world. Partially completed surveys were included in analysis as long as demographic questions were complete. Questions are referenced as Q1, Q2, and so on.

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