ALIGNING INTERNAL AUDIT WITH THE ORGANIZATION’S STRATEGIC OBJECTIVES

Mohamed Raoof, CPA, CIA  
Partner  
Horwath Al Muhanna & Co.  
Member Crowe Horwath International  
Kuwait

30 November 2016  
Version 1/15.10.16
Contents

- Rationale behind alignment – concepts and views
- Meeting stakeholder expectations
- IIA guidance on developing the strategic plan
- Challenges to transformation and closing the gap
RATIONALE BEHIND ALIGNMENT - CONCEPTS AND VIEWS
Internal Audit Value Proposition

In 2010 the IIA (Institute of Internal Auditors) introduced the value proposition for Internal Auditing, which characterizes internal audit’s value as an amalgam of three elements: assurance, insight and objectivity.

**Assurance = Governance, Risk, Control**

**Insight = Catalyst, Analyses, Assessments**

**Objectivity = Integrity, Accountability, Independence**
Internal audit defined

“Internal Audit is an independent, objective assurance and consulting activity designed to add value and improve an organization’s operations. It helps an organization accomplish its objectives by bringing a systematic act, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.”

The IIA’s definition of Internal Audit
Strategy defined

Strategy is "the quest to gain and sustain competitive advantage". It includes concepts such as being different from rivals, creating value while controlling costs, deciding what to do and what not to do, and developing a unique position.

Paul L. Walker – Strategy and Internal Auditing

Strategic planning is an organization’s process of defining its strategy or direction, and making decisions on allocating its resources to pursue its strategy. It may also extend to control mechanisms for guiding the implementation of the strategy.
Common elements found in internal audit and strategy definitions

- Both definitions mention value (adding value / creating value)

- Both definitions mention achieving something:
  - Adding value and improve an organization’s operations (*Internal Audit*)
  - Gain and sustain a competitive advantage (*Strategy*)
  - Internal audit’s definition specifically includes risk and governance; these are among functions that are important for an organization to achieve its strategy.

The definition of internal auditing therefore seems to suggest that many internal audit goals are consistent with the organization’s goals and strategy.

*Paul L. Walker – Strategy and Internal Auditing*
Tying Risk To Strategy

Strategic objectives are mentioned in the Performance Standards under Risk Management as below:

“The internal audit activity must evaluate risk exposures relating to the organization’s governance, operations, and information systems regarding the: achievement of the organization’s strategic objectives; …….”

Strategic objectives pertain to the value creation choices on behalf of the organization's stakeholders

*From IPPF- Standard 2120. A1*
Objectivity principle limitation

- While the standards do indicate the need to get involved with strategy and strategic risks there is also a need to exercise caution in order to adhere to the objectivity principle which states internal auditors “shall not participate in any activity that may impair or be presumed to impair their unbiased assessment”.

- We can, in this regard, seek guidance from the IIA Position Paper: *The Role of Internal Auditing in Enterprise Wide Risk Management*, which provides a range of ERM activities and indicates which roles an effective professional internal audit activity should and, equally importantly, should not undertake.
Limits to involvement beyond assurance

Core internal audit roles in regard to ERM

- Facilitating identification & evaluation of risks
- Evaluating the reporting of key risks
- Giving assurance that risks are correctly evaluated
- Giving assurance on the risk management processes

Legitimate internal audit roles with safeguards

- Reviewing the management of key risks
- Coordinating ERM activities
- Consolidated reporting on risks
- Championing establishment of ERM
- Maintaining & developing the ERM framework
- Setting the risk appetite
- Developing RM strategy for board approval
- Imposing risk management processes
- Management assurance on risks
- Taking decisions on risk responses
- Implementing risk responses on management’s behalf
- Accountability for risk management

Roles internal audit should not undertake
Limits to involvement beyond assurance

**Core Internal Audit Roles in ERM**
- Giving assurance on the risk management process
- Giving assurance that risks are correctly evaluated
- Evaluating risk management processes
- Evaluating the reporting of key risks
- Reviewing the management of key risks

**Legitimate IA Roles, w/Safeguards**
- Facilitating identification and evaluation of risks
- Coaching management in responding to risks
- Coordinating ERM activities
- Consolidated reporting on risks
- Maintaining and developing the ERM framework
- Championing establishment of ERM
- Developing ERM strategy for board approval

**Roles IA Should Not Undertake**
- Setting the risk appetite
- Imposing risk management processes
- Management assurance on risks
- Making decisions on risk responses
- Implementing risk responses on management’s behalf
- Accountability for risk management

*Figure 1 - Internal Audit’s role in ERM. From The Institute of Internal Auditors (2009) IIA Position Paper: The Role of Internal Auditing in Enterprise-wide Risk Management.*
Risk based auditing requirements

- A basic underlying theory of risk based auditing is to align the audit with the objectives, risks and goals of the enterprise. If internal audit is to provide true value to the organization, it must focus on those risks that would prevent the organization from meeting its overall goals.

- The fourth principle identified by the IIA is to “align strategically with the aims and goals of the enterprise.” This alignment can help ensure that the risks identified in the audit plan also address the risks the organization may view as a threat to its strategic objectives.

- For internal audit to execute a risk based audit, a strong insight into the organizational goals, including strategic goals is required.
Other risk/strategic objectives references in IPPF

Section 2010 of the IIA’s Standards on Planning:
“The chief audit executive must establish a risk based plan to determine the priorities of the internal audit activity, consistent with the organization’s goals”.

Practice Advisory 2010.1:
“The audit universe can include components from the organization’s strategic plan. By incorporating components of the organization’s strategic plan, the audit universe will consider and reflect the overall business’ objectives.”

Technically, therefore, knowing the organization’s strategy and strategic objectives, and incorporating them into the audit plan is required under the IPPF Standards.
MEETING STAKEHOLDER EXPECTATIONS
Why Internal Audit needs to meet stakeholders expectations

“Your key stakeholders have the last word on whether you are doing your job well. And they judge an internal audit function not by how well run it is, but by the value it generates for them……If stakeholders don’t value your internal audits, eventually they won’t value internal auditors either.”  

(Richard F. Chambers)

“Current views of internal audit’s role and the value it brings to the organization suggest internal auditors must build on the trust they have with stakeholders, and seek out better ways to add value.”  

(Anton van Wyk)
The various stakeholders

Internal Audit has several groups of stakeholders who could be categorized as below:

**Primary stakeholders**: audit committee, board of directors, CEO, CFO, other chief officers of the enterprise.

**Secondary stakeholders**: Business unit executives (the auditees, our clients).

**Tertiary stakeholders**: Employees, investment analysts, shareholders, external auditors and regulators.

*Classification from “Lessons Learned on the Audit Trail”, Richard F. Chambers*
What IIA studies reveal

- The CAEs who participated in the CBOK 2015 practitioner survey concluded that to provide the highest level of service to their organizations, internal auditors should collaborate with their stakeholders to align performance measures to their top priorities.

- The IIA’s Defining Our Role in a Changing Landscape (issued in 2013) showed that the limited coverage on strategic business risks in the audit plan appears misaligned with respondents’ assessment of the importance of this area to stakeholders.

- Strategic business risks consistently receive less coverage (in audit plans) than competing risk areas. The limited coverage on strategic business risks appears misaligned with respondents’ assessment of the importance of this area to stakeholders. (The IIA’s North American Pulse of the Profession Survey, 2013)
What IIA studies reveal

- The IIA’s *Insight: Delivering Value to Stakeholders Study 2012*, which surveyed both CAEs and stakeholders found that being successful internal auditor today means “engaging executives and board members in thoughtful consideration or current business challenges and in supporting the development of strategies to address the associated business risks.

- There is a high expectation among practicing internal audit leaders and key stakeholders - at both board and executive level - for internal audit to deliver insight. The research also affirmed that internal audit is not consistently meeting that expectation. *(The IIA Research Foundation Research, 2011)*
What other surveys reveal

- Several global surveys on the profession provide the following insights:
  - There is an increase in expectations of more value from internal audit.
  - Many stakeholders want internal audit to expand its value beyond its traditional role of assurance.
  - There is an increasing trend in expectations for internal audit to be a more proactive Trusted Advisor.

- Crowe Horwath’s ongoing research among listed companies in Kuwait indicate:
  - Internal audit’s views on controls and risk issues relating to strategic initiatives are sought, though its involvement otherwise in strategic initiatives is very limited.
  - While expectations revolve mostly around risk and control assurances, respondents did indicate business improvement recommendations as a value driver.
IIA GUIDANCE ON DEVELOPING THE STRATEGIC PLAN
Strategy must drive tactics and not the inverse

- The internal audit function contributes to better overall governance when it operates within a strategic framework established by the audit committee and senior management (primary stakeholders).

- A formal strategic plan must be developed defining the value proposition of the internal audit function.

- The IIA issued the IPPF – Practice Guide, Developing the Internal Audit Strategic Plan in 2012. It provides useful guidance on how to develop an internal audit strategic plan.
Developing the Internal Audit Strategic Plan

The IIA provides an approach for developing the internal audit strategic plan as depicted and explained below:

- The starting point is to obtain a thorough understanding of the organization’s objectives and the industry in which it operates. This should cover an in-depth understanding of strategic, operational, reporting and compliance objectives.
  - This could be achieved either through a “seat at the table” or by maintaining a connection with and understanding of the enterprise risk management process.
Developing the Internal Audit Strategic Plan

The IIA provides an approach for developing the internal audit strategic plan as depicted and explained below:

- The values the internal audit activity’s personnel should adopt are contained in the IPPF Framework Standards and Code of Ethics.

- Relevant standards mentioned in the Practice Guide are the several Attribute Standards and the Performance Standards.
Developing the Internal Audit Strategic Plan

- Understanding stakeholder expectations and needs is a critical step. Key internal and external stakeholders are to be included. Common internal audit outcomes include:
  
  - Risk management and control assurance
  - Assessment of internal control effectiveness and efficiency
  - Regulatory and corporate compliance assurance
  - Timely response to urgent and critical events
  - Business improvements
  - Insights and advice on control and risk issues relating to operations
Vision and mission statements are to be developed and updated based on stakeholder expectations and IIA guidance.

- The purpose of the vision statement is to articulate the internal audit activity’s philosophy and what it hopes to contribute to the organization.

- The mission statement outlines the internal audit activity’s primary business purpose, what it plans to achieve in the future, its values and how it integrates into the organization’s strategic plan.
developing the internal audit strategic plan

- Critical success factors relevant to the internal audit activities are to be identified. Three questions that could be asked are:
  - **Positioning:** Is the internal audit activity strategically positioned and supported?
  - **Processes:** Are the internal audit’s processes enabling and dynamic in meeting business needs?
  - **People:** Does the internal audit activity have the right people strategy to deliver its mission?
Developing the Internal Audit Strategic Plan

- Perform an assessment of the current state of the internal audit activity to identify the key internal and external factors that are important to achieving the strategy:

- Topics to consider would include:
  - The internal audit activity’s organizational structure
  - Skill sets and knowledge of the internal audit team
  - Technology and tools
  - Sourcing model
  - Coordination with other risk management and assurance functions
  - Methods to deliver services
  - Communication with stakeholders
Developing the Internal Audit Strategic Plan

- Identify and prioritize the key initiatives towards achieving the internal audit activity’s critical success factors and its vision and mission. Illustrative examples of initiatives corresponding to certain critical factors are given below.

<table>
<thead>
<tr>
<th>Critical success factor</th>
<th>Key initiative</th>
</tr>
</thead>
<tbody>
<tr>
<td>Focus on the organization’s highest risks</td>
<td>Enhance the planning process to identify the highest priority strategic, operational, financial and regulatory risks.</td>
</tr>
<tr>
<td>Provide impactful reporting to shareholders</td>
<td>Increase the transparency of internal audit’s activities through providing timely communications to stakeholders on the global collection of risks, audit findings and issue remediation efforts.</td>
</tr>
<tr>
<td>Maintain efficient and effective audit processes</td>
<td>Develop a manual that defines the methodology for performing all internal audit assurance and consulting engagements.</td>
</tr>
<tr>
<td>Adequately skilled and knowledgeable staff</td>
<td>Identify the critical skills, create development plans, and develop a sourcing strategy to deliver on the mission statement.</td>
</tr>
</tbody>
</table>
CHALLENGES TO TRANSFORMATION AND CLOSING THE GAP
Challenges and solutions to transformation

As per research findings internal audit departments looking to participate in strategic matters face challenges (and, in turn, opportunities) in several areas.

- **The Internal Audit Mandate:**
  - The expectations for internal audit are not only changing but also expanding. Internal audit departments will need to change their mandate by better aligning audit coverage with the organizational initiatives and risks and not remain limited primarily to compliance and controls.

- **The Internal Audit Staff:**
  - Internal audit staff need to include people with not only a traditional background in audit and finance, but are also business minded and with specialized and problem solving skills.

- **Internal Audit Operations:**
  - Internal audit departments need to take a “small-speedboat approach” and be able to alter course quickly, refreshing their annual risk assessments and audit plans throughout the year.
Challenges and solutions to transformation – cont’d.

- Develop or acquire enabling infrastructure, methodology and technologies:
  - Internal audit technologies can greatly improve the efficiency, quality and consistency of the audit process. However, such investments should be driven solely by business goals and the company’s risk profile.

- Measure Internal Audit Value:
  - Internal audit must add value, measure and communicate that value to management and move beyond basic metrics such as amount of time to issue reports or resolve audit findings. To gain the attention of stakeholders, internal audit must instead highlight its impact on the bottom line.

- Engage and adopt a strategic and risk mindset:
  - This could be achieved by maintaining a connection and understanding of the ERM process, which is likely to have strategic insight into organizational goals and strategies. Engaging with the business would also mean learning things sooner, building relationships and respect and building the internal audit brand.
FINAL THOUGHTS

 “For internal audit to remain relevant, it should adapt to changing expectations and maintain alignment with the organization’s objectives. The internal audit strategy is fundamental to remaining relevant – playing an important role in achieving the balance between cost and value, while making meaningful contributions to the organization’s overall governance, risk management and internal controls”

(From the IPPF – Practice Guide, Developing the Internal Audit Strategic Plan)

 “Businesses and strategic plans face an increasingly uncertain future, and internal auditors have an opportunity to help. They should try to use that opportunity to become more strategic internal auditors and trusted advisors.”

(Paul L. Walker – Strategy and Internal Auditing)
ANY QUESTIONS?
THANK YOU FOR YOUR ATTENTION!