INTERNAL AUDIT AS AN ORGANIZATIONAL FUNCTION

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Chair Emeritus of COSO
Audit Committee, Chair, Woodward, Inc.
Organizational objectives: A basis for internal audit planning

- Organizational Objectives and Key Processes
- Board/Management Needs
- Internal Audit Role?

[Diagram showing Mission, Vision, Aims or goals, and Objective with descriptions]

- Mission: The overall purpose of the business
- Vision: The overall aspiration of the business
- Aims or goals: General statements of what business intends to achieve
- Objective: More precise & detailed statements of the aims / goals
Where does Internal Audit fit?

- **[Definition]**
  Internal auditing 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, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

- **[Mission]**
  To enhance and protect organizational value by providing risk-based and objective assurance, advice, and insight.
Traditional ways Internal Audit has looked at organizations

Are we too focused only on the bottom half?
The internal audit function

Two Recent Publications

<table>
<thead>
<tr>
<th>People</th>
<th>What is Needed</th>
<th>How To</th>
</tr>
</thead>
<tbody>
<tr>
<td>□ Integrity.</td>
<td>1. Anticipate Stakeholder Needs</td>
<td></td>
</tr>
<tr>
<td>□ Competence</td>
<td>2. Forward Looking Risk Management</td>
<td></td>
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<tr>
<td>□ Objective</td>
<td>3. Advise Board and Audit Committee</td>
<td></td>
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<tr>
<td>□ Aligned with Org Strategy/Risks</td>
<td>4. Be Courageous</td>
<td></td>
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<tr>
<td>□ Appropriately Positioned</td>
<td>5. Support Business Objectives</td>
<td></td>
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<tr>
<td>□ Quality and Continuous Improvement</td>
<td>6. Address Technology Risks</td>
<td></td>
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<tr>
<td>□ Effective Communicators</td>
<td>7. Data Analytics / Analysis</td>
<td></td>
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<tr>
<td>□ Risk-Based Assurance</td>
<td>8. Go Beyond the Standards</td>
<td></td>
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<tr>
<td>□ Insightful, proactive, future-focused</td>
<td>9. Invest in Yourself</td>
<td></td>
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<tr>
<td>□ Promotes Organizational Improvement</td>
<td>10. Become Team Members</td>
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</table>
My Perspective as Audit Committee Chair

- **Comfort**
  Financial controls are present, risk responsive, operative and effective.

- **Organizational, operational, and effectiveness knowledge**
  - Operations
  - Efficiency and Effectiveness
  - Other sources of Assurance

- **Risk Knowledge**
An Audit Committee perspective

- **Effective Communication**
  - Write from a Board/Management Viewpoint
  - Timely, with Insight
  - Demonstrate Knowledge of Context
  - Approach Taken – not the emphasis

- **Flexibility**
  - Address new, emerging risks
  - Strong Toolbox – personal abilities plus technology
Mapping Internal Audit into these needs: Is it a career?

- Knowledge requirement is great, but remember: *Internal Audit is not part of management.*

**Dependent on:**
- Governance
- Objectivity, quality, and knowledge
- Strong tools
- Communication effectiveness
- CAE leadership
- Continuous Improvement / training / rotation
- Sufficient funding: built on a history of accomplishments
Internal Audit
Where do you want to be?

Expertise

Audit/Assurance
Consultive/Business

Operations / Processes

Audit Focus

Financial Controls / Compliance
Internal Audit
Where do you stand?

Expertise

<table>
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<th>Audit/Assurance</th>
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<tr>
<td>Operation / Processes</td>
<td>Financial Controls / Compliance</td>
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</table>

Audit Focus

A
B
C
D
Internal Audit
Where do you stand?

Expertise
- Audit/Assurance
- Financial Controls / Compliance
- Consultive/Business
- Operations / Processes

Audit Focus

Do not confuse approach with service provided
Match career approach with value proposition for Internal Audit

Expertise
- Audit/Accurance
- Consultive/Business

Audit Focus
- Financial Controls / Compliance
- Operations / Processes

Career

Training Ground

Rotational

Combined Assurance?
Considerations in developing staff

- Education
- Individual growth opportunities
- Understanding the business – best approach
  - Training
  - Secondment
- Rotational
  - At what level?
  - Return to Internal Audit
- Courage / Independence / Competence
A Few Comments on Courage

Taken from work by Patty Miller and myself:

"The Politics of Internal Auditing"
Cases
A large Government Agency

- A large Governmental Agency
- Subcontracted implementation
- Audit was selected to look at profit sharing, later expanded to fraud.
Survey
Extent of pressure

- 55% suppress finding
- 49% not audit high risk
- 31% audit low risk area
Respect and support from those in governance is important.

**Exhibit 4.17. Strong Support Correlated with Less Political Pressure**

<table>
<thead>
<tr>
<th>SUPPORT OF:</th>
<th>SUPPRESS FINDING</th>
<th>NOT AUDIT HIGHER RISK</th>
<th>AUDIT LOWER RISK</th>
</tr>
</thead>
<tbody>
<tr>
<td>Audit committee</td>
<td>88.4%</td>
<td>91.7%</td>
<td>83.2%</td>
</tr>
<tr>
<td>Executives</td>
<td>79.9%</td>
<td>78.2%</td>
<td>72.6%</td>
</tr>
</tbody>
</table>
Summary of findings

1. Political pressure is extensive and pervasive.
2. Political pressure comes in many forms.
3. Good Corporate Governance is fundamental.
Summary of findings

4. Political pressure can be managed and partially mitigated, but it is always present.

5. Professional competence is required, but is not sufficient.

6. Must audit at the “Speed of Risk” (Richard Chambers).
Summary of findings

7. Political pressure exists for:
   - Traditional CAE (career CAE)
   - Rotational CAE’s

8. Other:
   - Fraud Detection
   - Staff consistent with mission of organization.
Courage, Creditability and Trust

- **Build strong relationships**
  - Board and Audit Committee
  - Cadre of successful audits
  - Tone at the top is developed with first communication.

- **Raise the right issues**

- **Listen fairly and objectively, but remember your ethical compass**

- **Build and maintain a strong internal audit team**
Courage, Creditability and Trust

- Provide fact-based conclusions with clear business insight

- One approach: "We are all on the same team".
  - Understand the perspective of those resisting the report
  - Identify common points
  - Work to resolve, but ultimately, it is your duty to present your findings and insight
  - Determine importance of issue
Our Conclusion:

Internal audit must assess itself and determine whether its value proposition is understood by, and aligned with, that of the organization. Moreover, the CAE must build and staff a strong function that provides that value. The CAE needs to possess integrity and gain credibility and respect by understanding the business, building relationships, demonstrating objectivity and good judgment, and communicating tough issues fairly and thoughtfully.

Addressing political risk is not an easy task. But it is essential to the success — and even survival — of the internal audit function, and the organization it serves.
Internal Audit must engage in its internal risk management, including political risk.

IA Risk Management

- Understand and clarify your role
- Build alliances and credibility
- Understand evolution of organizations.

Risk Approach:

- Internal Environment
- Objective Setting
- Event Identification
- Risk Assessment
- Risk Response
- Control Activities
- Information & Communication
- Monitoring
Objectives:
Risks must be navigated

Expertise gained

Adding Value: attainable and worthwhile.

Thank you