



Issue 6

GLOBAL PERSPECTIVES AND INSIGHTS:

Elevating Internal Audit's Strategic Impact

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Introduction

The increasing importance of internal audit's role as the third line of defense in effective risk management and control has raised its visibility both within and outside of the organization. As a result, chief audit executives (CAEs)¹ and internal audit departments are looking for ways to utilize their unique expertise to enhance their value to the overall corporate mission. This leads to the question — asked by all high performing support areas such as finance, human resources, IT, and legal — how can we have a strategic impact on the organization?

Internal audit is uniquely positioned to be a strategic partner. With reporting relationships to the chief executive officer (CEO) or other executive officer, audit committee, and the board, high performing CAEs combine intelligence, expertise, diligence, and curiosity in a manner that positions internal audit for a critical strategic role. Despite this, CAEs are not generally recognized for the potential strategic impact that they can have on their organizations. For CAEs looking to elevate the strategic role of internal audit, several questions should be answered to take this next logical and desired step. Does the CAE understand the strategic mission of the organization at a deep level? Does the CAE understand the perspective of the CEO and board and make the effort to become a trusted partner, offering advice and solutions that address key problems? Is internal audit aligned with the strategic mission? Is internal audit anticipatory and proactive (rather than reactive)? Does the CAE provide assurance on risk management?

Unfortunately, traditional perceptions of internal auditing can lead to wariness on the part of others to embrace internal audit as a strategic partner. Further, internal audit must balance the independence that is required for its role against the level of involvement in the tactical duties necessary to achieve the organization's goals. After all, it is the mandate of internal audit to assess these tactics. But proactively addressing these challenges can lead to a real opportunity for internal audit to be recognized as a strategic partner and contributor.

¹ CAE describes the chief audit executive, head of internal audit, or other senior position responsible for effectively managing the internal audit activity.

Understand Your Strategic Mission

Luz Dary Bedoya Bedoya of Audilimited, Organización Corona in Colombia, explains, “It is impossible to audit a process without an understanding of the process objectives, governance rules, and industry context. It is the same for the business: It is impossible to develop an appropriate annual audit plan without a profound knowledge of the business strategy.” Consequently, an initial key step in elevating to be a strategic partner is understanding the organization’s strategic mission, the objectives designed to accomplish that mission, and the metrics by which success will be measured.

Thus the CAE must analyze what is the strategic mission of the organization as well as the underlying strategic intent for that mission. While a seemingly simple task, it is important to understand. If internal audit does not understand the strategic mission and strategic intent of the organization, it cannot progress toward being viewed as a strategic partner.

Moreover, understanding the strategic mission requires a deep knowledge of the operational plan to execute the strategic mission and all that comes in between. The strategic plan is usually comprised of strategic objectives designed as steps to achieving the plan and a set of measurement benchmarks that will be used to determine success. These strategic objectives and tactical initiatives, combined with the evaluative measurements, are important because they will drive the behavior of the entire organization and each individual business unit. If a senior executive and a business unit are tasked with certain supporting objectives and will be evaluated based on achieving those objectives, these objectives will inform the CAE and internal audit where to focus on identifying the risks of the strategic plan. This analysis includes asking important questions. Do the underlying objectives and measurements support the strategic plan? Do the measurement criteria align with and support the objectives and the strategic mission? Do the objectives and metrics create incentives that can increase risk, especially if the objectives are in danger of not being accomplished? Who is accountable for each of the objectives and do they have the authority to execute the strategy?

As one can see, the more aligned the CAE and internal audit are with the strategic mission, the more likely the risks associated with the mission, objectives, and measurements will be identified and assessed. Further, a deeper understanding of the strategic plan will better inform internal audit to best serve the organization in a way that is most important to the board and executive management. Unless internal audit has a detailed understanding of the organizational units’ tasks and the way the units will be measured for success, internal audit will be viewed as offering less relevant advice, help, or assistance. Without this strategic context, an organizational unit will tend to politely decline or rebuff internal audit’s advisory efforts because internal audit’s support will be perceived as having no strategic or other value. Understanding and aligning to the strategic plan helps internal audit offer meaningful and relevant assurance and support that will help the organization better solve business challenges.

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Elevating the Strategic Value of Internal Audit

In high performing organizations, every part of the organization would like to contribute on a higher level, whether it is sales, operations, or administrative support. Internal audit is not alone in its desire to offer its expertise at a strategic level. Other traditional corporate and administrative functions have had similar challenges and have found success in growing beyond their historical roles. The chief financial officer (CFO) transitioned from a narrow reporting role to a broader strategic business role by offering unique insight into the financial results. The human resources department moved from staffing to strategic personnel management by tying the importance of the right people to achieving results. The chief information officer (CIO) and general counsel are also elevating their strategic profiles and impact. Therefore, the path to elevating internal audit can be seen through the successful examples of the progress of other areas in enhancing their roles. And internal audit is specifically uniquely positioned, through its broad organizational purview and reporting relationships, to capitalize on this in today's ever-challenging business environment.

Understanding the CEO

While we speak of missions and initiatives and plans, an organization's strategy starts with an exchange of ideas between the CEO, their leadership team, and the board. These ideas are drawn from the CEO and board's experience with and perspective of the organization, its capabilities and challenges, client or customer needs, the overall market environment, and even world events. All these factors come to bear on the thoughts of the CEO and the board and form the perspective that underlies evaluation of the future strategic mission. The CAE must understand this perspective to elevate his or her value.

Understanding flows from relationships built at the highest levels, and the overall relationship between the internal audit function and the organization will be reflective of the CAE's interaction with the CEO, audit committee, and the board.

Oliver Dieterle of Bundesagentur für Arbeit in Germany stresses the importance of the CAE's interaction with the board: "The CAE has to understand the business from the board perspective. Without that, he or she will not become a partner. The CAE also has to understand the CEO." Bedoya adds, "Another important step to raise the bar is to understand and discuss the strategy and risks of the business with management. CAEs must understand the business as the CEO understands the business. Then they can focus attention on what is important for the CEO and for the board and adopt their own strategy to support these priorities."

Maria Craig of Homes and Communities Agency in the United Kingdom notes that the "partnering" aspect of being a "strategic partner" conveys an "equal and shared/common desire to work together at the highest level of the organization to achieve what is best for the organization." Implicit in this is an

understanding that there are two willing parties to partner ... with each party seeing value in what the other party brings to the table.

Yet partnering does not mean that there is an equal partnership in all responsibilities. As Craig points out, strategic direction is ultimately determined by the board and senior management and "Internal audit needs to recognize the roles within its organization that are key to that process and acquire a comprehensive understanding of both the business as it currently is and where it is moving." But despite the desire for internal audit to be strategic, its role is to audit, assess, evaluate, and consult. Internal audit's role is not to contribute to the strategy, as an active participant in strategy setting. Rather, its role is to understand the strategy deeply so that internal audit is best positioned to identify the risks inherent in achieving the strategy, and whether those risks are properly managed. Having a seat at the table, being physically present during strategy development, provides much better context than just reading the strategic plan on the back-end.

Becoming a Trusted Partner

After the CAE understands the perspective of the CEO and the board, the CAE needs to build professional rapport and trust within the whole organization. This requires the CAE to bring his or her expertise to broader business challenges. Note that the goal is to recommend solutions, not simply to point out problems. The CAE's unique value is two-fold. One is a broad view and understanding of the entire organization. The other is a well-honed expertise in risk management, control, and governance processes. Combined, these bring unique perspectives to help identify and solve risk control problems related to the business challenges most impeding strategic success.

Dieterle notes, "Becoming a trusted adviser means communicating in a way that makes the CEO accept the CAE as 'one of the executive team.' In addition, you have to talk to the executive team and the senior management in your organization. You need to understand their perspectives and their business. This requires change and, to some degree, broadening the perspective beyond his or her field. The challenge is for the CAE to be business-minded, but clear in his or her core role as internal auditor."

With a good partnership, the results can be very positive. John Bendermacher of ABN AMRO Bank in the Netherlands relates his personal experience: "As the CAE, I have bilateral meetings with the chairman of the managing board very regularly. In these meetings I can bring strategic impact of findings and issues to the table. Beside these meetings, I am consulted by the chairman as well. For this I do not always have to write a memo or report; in fact, it might be even more effective as verbal communication." During a recent strategy and organization review, Bendermacher was able to get several ideas and observations integrated into the strategic review leveraging his access as an opportunity to add value.

"**Becoming a trusted adviser means communicating in a way that makes the CEO accept the CAE as 'one of the executive team' ... You need to understand their perspectives..."**

Oliver Dieterle, CAE,
Bundesagentur für Arbeit

COSO ERM Update:

COSO is in the process of updating its 2004 Enterprise Risk Management—Integrated Framework, entitled *Enterprise Risk Management—Aligning Risk with Strategy and Performance*. This update recognizes the increasing importance of the role of the CAE and internal audit in helping to guide strategy. In particular, the draft seeks to provide further insight into the proper role of ERM when setting and executing strategy. Further, the draft offers a different perspective on ways to view risk in setting and achieving objectives in a world of increasing business complexity.

The COSO update encourages boards to go further in using ERM in “selecting and refining strategy.” The authors suggest there must be a shift from evaluating risk against strategies that have already been determined to using ERM in the strategic process. They explain, “Enterprise risk management helps to make the evaluation of strategy rooted in the decisions made by senior management much clearer. It clarifies how strategy selection can be enhanced. Choosing a strategy calls for structured decision-making that analyzes risk and aligns budgets and activities with the mission and vision of the organization.”

Supporting the Strategic Mission as a Team

As important as the role of the relationship between the CAE and the CEO and board is, it is equally important to build a strong relationship between the internal audit staff and the rest of the organization. While staff will struggle to be strategic without a strategic CAE, the internal audit team must have the desire and preparation required to support taking on a strategic role. As with most organizational challenges, success is dependent on the right combination of technical and people skills.

The first step is to create buy-in to the different and more top-down approach in everything internal audit does and prioritizes. Craig advises, “Be clear on what it is you want to achieve and why. ‘It’s a team thing’ so recognize that everyone needs to play a part. You should get buy in from your own team first before tackling the rest of the organization. And communicate your aims clearly with the board, audit committee, and executives, and get agreement and support at the highest level.” The CAE can help the effort by developing a communication plan for stakeholders, especially the board and executive team. Bendermacher recommends, “Show the board how the strategy is handled by the business. Perform a top-down risk assessment and provide assurance (or add value) to the process of controlling, monitoring, and reporting on strategy progress.” Orienting the entire audit team to consider the strategic mission in how it approaches detailed audit work takes time, skills, and talent.

A different approach may certainly require new talents, so the CAE must support the internal audit team with training beyond technical skills to broader business and soft skills. Giovanni Grossi, honorary president of IIA–Italy, identifies personal interaction as a skill of great importance to internal audit. “This new strategic role requires developing an attitude that implies a higher ability to handle difficult interpersonal interactions and the courage to face the risk of interpreting a brand new role with very limited historical points of reference.” Bedoya goes a step further, noting how the internal audit role can cause difficult discussions with others in the organization. “In discussing differences with management, internal audit must be collaborative. Not everything that management does is right or wrong, and auditors have the obligation to advise them about the risks of their opportunities by being firm in addressing the problem, but sensitive in addressing the person.”

Grossi suggests that a good deal of internal promotion may be needed within the organization. Internal audit should advocate for the new approach and highlight the value of their new role, so that the organization can prepare for and appreciate the results. “Giving them a gift they do not understand is worthless, so we need to convince them of the value of being willing to go beyond expecting just the traditional deliverables of the internal audit profession.”

Elevating Risk Management

No strategic discussion can occur without a discussion of risk. “Risk” is half of the tradeoff between “risk and reward.” Simply put, there is no strategic direction or initiative an organization can take that does not involve some level of risk. And as one does not jump from the plane and pack a parachute on the way down, an organization should not set a strategy that did not include a deep understanding of the risks before such strategy is agreed upon. This is where the CAE can be strategically effective. The CAE must relay to the board not just the risks of the initiative, but how such risks can or will be controlled and whether the control process is part of the current control framework or requires different resources. Grossi comments, “It is imperative that we make our internal clients aware of the contributions our profession may deliver by getting ahead of events instead of reacting to events that have already happened.”

It is clear that tactical risks of a range of strategic initiatives are discussed during the development of an organization’s strategic mission, but only the CAE can offer a proactive, complete, integrated picture of the risk management strategy. A CAE who thinks like a CEO and is trusted by the board can provide comfort to the board that the operational plans will be executed while managing the risk to the organization. As stated in the COSO exposure draft entitled *Enterprise Risk Management—Aligning Risk with Strategy and Performance*, a strategic ERM plan “provides an effective way for a board to fulfill its risk oversight role by knowing that the organization is attuned to risks that can impact strategy and is managing them well.”²

Because many organizations have not elevated internal audit to a strategic role, this level of interaction is not commonplace and the CAE has the opportunity to show that internal audit can enhance the enterprise value of the organization by providing a level of risk management, control, and governance insight that is truly unique. Thus, if the CAE can demonstrate that the organization’s risk management, control, and governance processes are a competitive business advantage, or why they are not, the CAE will have established real strategic value.

COSO ERM Update: (continued)

Further, the COSO draft sees a strategic ERM function as enhancing “enterprise resilience,” which it defines as an organization’s ability to anticipate and respond to change, by providing critical analysis in times when strategy must be altered due to changing business conditions. Thus, the COSO draft firmly supports a move toward a more strategic role for the CAE and internal audit.

Source: Committee of Sponsoring Organizations of the Treadway Commission (COSO), *Enterprise Risk Management—Aligning Risk with Strategy and Performance* (Public Exposure Draft), Executive Summary, June 2016, 5, 3.

² Committee of Sponsoring Organizations of the Treadway Commission (COSO), *Enterprise Risk Management—Aligning Risk with Strategy and Performance* (Public Exposure Draft), Executive Summary, June 2016, 2.

ISO 31000 View:

ISO 31000 takes a holistic view of integrating risk into the organizational fabric with less of an emphasis on specific processes. ISO 31000 sees the ERM function integrating factors such as a proportionality that is based on the size, nature, and complexity of the organization, alignment with the scope of the corporate mission, integration into the culture of the organization, responsiveness to changes affecting the organization, and comprehensive in nature.

Risk management policy should discuss risk in a forthright way including what is the organizational appetite for risk and how risk is expressed in the corporate culture. The business objectives of the organization should be evaluated expressly in risk terms with key assumptions and dependencies understood. ISO 31000 sees the organization as developing key risk indicators that, when found during the execution of the business plan, have remediation processes clearly identified and ready to be executed. With risk management woven into the complete fabric of the organization, ISO 31000 properly stresses the responsibility of the whole organization in the prevention, identification, and management of organizational risk.

Challenges

Traditional Views of Internal Audit

Fundamentally, the mission of internal audit is to enhance and protect organizational value by providing risk-based and objective assurance, advice, and insight. This is accomplished through risk management, control, and governance approaches and processes that ensure the CEO, board, and management are informed of the spectrum of key strategic and operational risks facing the organization, and whether they are being well-managed. Since a strategic discussion involves weighing the many options facing the organization, the underlying risks are critical and will be discussed whether or not the CAE is present. But if the issue of risk is very important and will be discussed, why would the CAE not be present?

At times, internal audit is seen as the “police force” of the organization; looking for problems and reporting on them and seen as a potential restraint or challenge to executing a strategy. Overcoming this traditional relationship between internal audit and the organization is the first challenge in elevating internal audit to a more strategic role. Internal audit should recognize that this view is not necessarily a misconception, as protecting the value of the organization has been the primary job of internal audit historically, but it is a narrow view of the internal audit function. As with any change, the idea of internal audit as a creator of value, in addition to being a protector of value, will become more pervasive as the CAE and internal audit team take the measures described herein. There is no magic formula for changing the perception of an organization overnight, but this traditional — and simplistic — view will be replaced as the CEO and board start to see the CAE contribute at a strategic level and expand his or her professional and organizational value.

Objectivity and Independence

The challenges do not end when internal audit is accepted as a strategic partner to the CEO and board. Assuming the CAE and the internal audit team achieve recognition as a strategic partner, perhaps the biggest intrinsic challenge faced by the CAE and internal audit team is balancing objectivity with an enhanced consultative role. It is simply beyond debate that to be more effective, internal audit must interact with the organization, but this interaction, if taken too far, can result in a vested interest in the outcome that can affect objectivity. On this point, Bedoya acknowledges the importance of collaboration, but she stresses the need for a constant focus on remaining objective. “The most important thing is to be personally objective and maintain the independence of the internal audit function.”

Objectivity can be affected in other ways. Grossi sees some compensation trends affecting the objectivity of the CAE and asks what “sort of monetary and career incentives are provided to the CAE?” Bonus and stock incentives can be a powerful motive to perform, but also offers the chance that it may introduce motivating factors that are not in alignment with the CAE’s core mission. It is clear that a proper compensation package is required to attract and retain top talent, but care must be taken to structure compensation in a way that does not incent or appear to incent behavior contrary to the core function of the CAE. It is a delicate balance.

Summary

CAEs will achieve recognition of their strategic value by identifying strategic risk to the organization, assessing how risk is being managed, and offering solutions to the board and executive management that improve the management of risks impacting the strategic mission. The CAE can also advise on opportunities for the organization to use smart risk-taking as a competitive advantage.

By understanding the strategic mission of the organization at a deep level, learning to think like the CEO and board, becoming a trusted partner by offering solutions that solve problems, aligning the internal audit team with its new strategic mission, and using risk management as a source of competitive advantage, internal audit can become more strategic and aligned with organizational objectives. This will help retain internal audit's relevance and support its rightful role in balancing cost and value while making meaningful contributions to overall governance, risk management, and internal controls.

Bendermacher counsels patience and realistic expectations. “The strategy-setting process is considered a very confidential process, because it often leads to significant changes in markets, products, and/or the organization itself. Therefore, the willingness to include internal audit from the very start is not yet a common thing to do. Internal audit must develop a profound understanding of the organization’s strategy, the objectives that support it, the risks that affect the organization’s ability to accomplish the objectives, and the risk responses identified by management. This understanding must be supported by a thorough grasp of the business, the relevant industry, and stakeholder expectations.”

All of the steps discussed should be used to create an internal audit operating strategy that details activities internal audit must take to support strategic initiatives and key milestones. Craig notes the importance of this step, “Consideration of the organization’s future activity and the key strategic risks to the delivery of the strategic plan enables the focus of internal audit work to be appropriately aligned. Similarly, the requirement to clearly demonstrate the contribution internal audit makes in relation to assurance over the organization’s key strategic risks will ensure that the organization’s aims and objectives underpin all internal audit work.” Further, given the dynamic environment of

Focus Points:

To elevate the internal audit function:

- Understand the strategic mission of the organization.
- Understand the perspective of the executive team, CEO, and the board.
- Become a trusted partner by offering strategic solutions that help solve strategic problems.
- Align the complete internal audit team with the strategic mission.
- Help the organization embrace risk management as a source of strategic advantage.
- Align the audit plan with the strategic plan.
- Speak with the executive team, CEO, and the board in terms of impacts to the strategy.



For More Information

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today's business, the CAE should build in approaches that will facilitate internal audit's ability to adapt to the changing priorities of the organization. As Bedoya explains, "The clue is being willing to learn, doing the right thing, and to have strong leadership. CAEs need all these qualities to rise to the level of strategic partner and trusted adviser, and to align internal audit's strategy to the business strategy."

And, of course, the path will not always be smooth, but Grossi encourages continued effort. In his view, marrying internal audit and strategy enables avoidance of two negatives: "a negative for auditors, because remaining outside of strategy deprives them of the opportunity to gain a better profile and professional image, and a negative for organizations because many strategic initiatives fail due to a lack of the professional checks and balances internal audit can provide."

Organizational acceptance of internal audit's strategic perspective will not take place overnight. But Craig offers some general advice on how to keep moving the effort forward. "Embed your aims within the teams' collective and individual targets. Always honestly evaluate where you are now and pay attention to the risks and the barriers to change while keeping in mind that barriers can be within internal audit, within the organization, or external. Put in place plans to improve audit services — change in manageable successive steps — and continue to deliver outstanding service throughout." Most important, she stresses, is the old saying about actions speaking louder than words. "Do not just 'market' the new strategic perspective. Do it!"

