

How Do Internal Auditors Add Value?

By JAMES ROTH

Characteristics common to top-rated audit shops help to shed light on the nebulous concept of adding value.

THE DEFINITION OF "VALUE ADDED" CAN VARY considerably from one audit department to the next. For many practitioners, this phrase describes audit work that helps management improve the business, rather than assignments that simply verify compliance with policies and procedures. For others, the opposite meaning may apply. I remember, for example, asking a wise internal auditor to describe his department's innovative, value-added audit practices. Rather than discussing his own department, the auditor helped to broaden my understanding of adding value by saying, "Remember ... what adds the most value in a country where, for instance, corruption is prevalent, is compliance auditing."

The type of work or services that constitute value-added practice, then, is largely situation specific. What adds the most value for one organization, or even one area within an organization, might be a waste of resources somewhere else. Hence, the influence of individual circumstances gives rise to the question, "How can auditors identify the practices that will add the most value given their own specific situation?"

An obvious answer is, "Ask your stakeholders." Many auditors seem to have taken this approach, as evidenced by a recent survey conducted by The Institute of Internal Auditors (IIA) titled, "Value Added Services of Internal Auditing" (see "[Value-added Practices](#)" for survey parameters). The results show that 52 percent of surveyed internal auditors had gone through a major "reinvention" to add more value and that, within this segment, 95 percent gathered verbal and/or written input from one or more of their major stakeholder groups.

Soliciting input from stakeholders, however, is only part of the answer. If we rely solely on stakeholders to decide what types of services would add the most value, we limit ourselves to their knowledge of internal audit practices. But stakeholders are only aware of what they've seen us accomplish in the past. Given the major advances in our profession during the last decade, stakeholders' expectations are likely far lower than they should be. For this reason, auditors need to raise stakeholders' expectations by telling them—or, better, showing them—how much value we can add.

At the same time, we cannot adopt an exciting new practice without adapting it to the organization's culture and the stakeholders' needs. Some audit departments that tried control self-assessment workshops, for example, failed miserably. Either workshops couldn't be made to fit the organization's culture, or the auditors neglected to do the careful planning and tailoring needed to ensure the success of such programs.

Although what constitutes value-added activity will vary based on many factors, there are some general rules that apply across the board. Based on more than 10 years of researching internal audit best practices, I've identified four factors that can help auditors determine what will add the most value to their organization:

- A deep knowledge of the organization, including its culture, key players, and competitive environment.
- The courage to innovate in ways stakeholders don't expect and may not think they want.
- A broad knowledge of those practices the profession, in general, considers value added.
- The creativity to adapt innovations to the organization in ways that yield surprising results and exceed stakeholders' expectations.

Three of these factors — organizational knowledge, courage, and creativity — represent competencies and personal qualities that, for the most part, are self-explanatory. "Practices the profession considers value added," however, leaves much room for interpretation, and thus merits further attention.

Although reaching a consensus on profession-wide best practices may be nearly impossible, the research I've conducted helps to shed light on commonalities among leading audit departments. By consolidating these common qualities, I've created a profile of a value-adding audit department that may be helpful to auditors seeking to benchmark their own departments and provide potential ideas for positive change.

PROFILE OF A VALUE-ADDING AUDIT DEPARTMENT

To identify audit practices that add the most value, I began with a list of world-class departments nominated by participants in The IIA's Global Auditing Information Network. Next, I expanded this list based on my own observations and through information collected while networking with peers. I then narrowed the candidates to only a handful of departments by using a subjective process of elimination that included ensuring each chosen company represented a different industry and avoiding inclusion of departments whose practices were considerably alike.

Despite the significant diversity in their specific practices, I observed remarkable similarities in certain key areas among the final departments selected. Considered excellent by their peers, and representing a variety of sectors, these audit shops form a collective profile with the following five value-adding characteristics.

1. EXTENSIVE STAFF EXPERTISE The model of internal auditing as a training ground for recent college graduates is fading. Organizations demand more tangible value

from audit work than newcomers to the profession can typically deliver. In fact, an average of 10 years' business experience is not unusual in leading audit departments.

Top-notch audit staffs are multi-disciplinary, with experts such as engineers and accountants or individuals versed in other disciplines needed to thoroughly understand the business rotating through the department. A core of experienced audit practitioners, however, provides continuity and in-depth knowledge of audit skills.

Furthermore, these departments tend to be highly trained, with 75 percent or more staff members who are certified most with the certified internal auditor, certified information systems auditor, certification in control self-assessment, or certified government auditing professional designation. Members of these audit functions also tend to be particularly active participants in their local professional organizations.

The best auditors are also skilled in data analysis, using audit software to solve business problems no one else in the organization can master. In addition, many practitioners are becoming integrated auditors, combining information-technology and business-audit skills. Although this concept has existed for at least 15 years, many audit departments have only recently begun to succeed with it in practice.

Beyond in-house staff, world-class departments are complementing their own resources with selective outsourcing. Even a large audit staff cannot maintain in-depth knowledge of every computer application, investment product, and benefit plan in the organization. In fact, 45 percent of respondents to The IIA's Value-added Services survey used outside contract auditors to either cosource select assignments or outsource a substantial portion of their work. Of these, the average amount of work outsourced was 19 percent. Though well-staffed and endowed with a broad range of expertise, many of the best audit shops are still finding the need to enlist outside help.

2. A CHALLENGING WORK ENVIRONMENT Talented, motivated staff members are easily bored and require challenging work. Their creativity must be encouraged and rewarded, and their professional challenges must extend beyond regular audit assignments. The departments I researched, for example, tend to involve staff auditors extensively in decision-making processes. Every staff member helps determine the direction of the department, and volunteer teams not just the audit managers develop the department's new practices.

This approach to staff oversight does not represent laissez faire management. Instead, the department leader creates and then closely monitors processes that enable the employees to participate in management decisions. In addition, the leader ensures the audit department is a fun place to work a necessary component for creativity and projects a tone at the top that shapes a value-adding culture.

The culture established by these departments emphasizes partnership over independence, while never losing objectivity. Auditors are encouraged to be trainers, coaches, and counselors of internal control, not just evaluators. They are taught to always look for ways to improve the business instead of simply identifying control weaknesses.

3. ORGANIZATIONAL ALIGNMENT Leading audit departments that employ two or more audit managers typically align their departmental structure with that of the organization. That is, the audit managers are assigned to specific lines of business, where they develop in-depth knowledge of business-unit activities and long-term relationships with those in charge.

This structure is complemented by the use of "relationship managers" usually experienced auditors but sometimes all members of the department who are assigned to specific areas within the lines of business. Their job is to stay in touch with the area managers. Contact might consist of formal meetings at an assigned frequency or impromptu discussions. During both types of meetings, the auditors inquire about changes in the area that might lead to new risks, share best practices they've identified in other areas, and discuss common control weaknesses discovered among other departments. These meetings not only build relationships, but also keep the auditors in touch with the organization's changing risk profile.

Auditors in world-class departments are also included in major oversight committees, process design or redesign teams, and task forces. Their role on these teams is to ask crucial questions about risk and contribute their knowledge of controls.

4. PARTICIPATIVE, QUALITATIVE, REAL-TIME RISK ASSESSMENT

Twenty years ago, many audit departments began formalizing annual risk assessments. Auditors developed computerized risk models that assigned a risk score to every organizational unit, using weighted risk factors. Most of these factors were financial, such as transaction volume and average transaction size, and auditors used the risk scores to determine how frequently each unit should be audited.

Today, the best audit departments are minimizing or eliminating cyclical audits. Those that still use computerized risk models employ this tool simply as a starting point for discussions with executive managers. Ultimately, the goal of the department is to align its audit plan with the organization's strategic plan, helping management accomplish its objectives without costly or time-consuming surprises along the way. The auditors accomplish this goal by reviewing management's documented plan, but also by meeting with each executive manager, usually once a quarter, to stay abreast of the organization's evolving strategy and ever-changing risk profile.

To allow for this real-time risk assessment, annual audit plans are becoming more flexible, with a higher percentage of time remaining unallocated. Respondents to The IIA's Value-added Services survey, for example, left an average of 17 percent of their annual plan unallocated. The actual proportion of time these auditors spent on unplanned projects was 28 percent.

Some leading audit departments are increasing audit plan flexibility by assigning a percentage of audit time to major functional areas, like finance or information technology, without committing to any specific projects within these areas; the annual plan might simply include a list of possible projects and time frames. Based on this structure, then, auditors perform a detailed and timely risk assessment for each potential project before the department commits to it.

Another method used by top audit departments to increase flexibility is "stop and go" auditing. Often, this is a formal process with defined milestones. At each milestone, the lead auditor must persuade the audit manager that enough risk exists to justify proceeding to the next stage. Or, on a more informal basis, the audit department's culture might encourage auditors not to complete an audit just because it was in the annual plan or perform an audit step simply because it was included in the program. At every step of the way, the auditors ask themselves questions such as, "Given all the risks in the organization, is this the best use of my time?" and "Is there a great enough likelihood of uncovering a significant problem or opportunity here rather than somewhere else?" These practitioners constantly re-evaluate their priorities, fine-tuning their approach to fit rapidly changing needs.

5. AN ARRAY OF AUDIT SERVICES Consistent with the revised definition of *internal auditing*, world-class audit departments are not seeing themselves as an "appraisal function" but as a broader "assurance and consulting activity." In addition to traditional audit work, these departments offer an extensive menu of services. When the auditors identify an emerging risk, they ask management which of their products will provide the highest level of assurance. Although the services offered vary with the organization's needs, the following are the most common:

- Risk-based audits working with members of local management to identify the business risks they face.
- Process audits auditing an entire business process rather than an organizational unit and looking for ways to improve the process instead of simply trying to find control weaknesses.
- Pre-implementation reviews participating on new-product or system-development teams and/or reviewing the project at certain defined milestones.
- Self-assessment hosting workshops, administering questionnaires, and conducting structured interviews to address soft controls. Also common are self-assessment programs for hard controls in which the business units perform their own testing to obtain ongoing assurance while the auditors subtest their work, rather than performing all the detailed testing themselves.
- Internal-control education formal training programs designed and taught by internal auditors, as well as ad-hoc training, when needed, during assurance or consulting projects.

The auditors in world-class departments see their role as extending beyond just performing audits. Instead, they recognize the importance of providing management assurance about the organization's major risks, and they believe that audits are just one way of achieving this objective.

GAUGING SUCCESS

Some of the practices found among leading departments may mirror those of your own audit shop, confirming that your organization is in step with the dramatic and value-adding changes in the profession. Or, these practices may provide ideas for further improvement. Although the value-adding profile may serve as a useful benchmark, auditors should keep in mind that they, ultimately, are the best judges of the type of services that will best serve the organization. A representative listing of best practices should be considered only as a starting point for discussion, with further evaluations made according to the organization's specific environment, culture, and client needs.

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Further details regarding Roth's profile of value-added audit departments and survey of best practices in value-added auditing can be found in his books, *Adding Value: Seven Roads to Success* and *Best Practices: Value-Added Approaches of Four Innovative Internal Auditing Departments*, both of which are available through [The IIA bookstore](#).

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