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Vonya Global: Executive Survey on the Strategic Role of Internal Audit

Final Report
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Executive Summary

The following is a sampling of the survey results.

Internal Audit is aligned with the organizations strategic direction, has a shared vision for internal audit, and shares the same goals and objectives for the internal audit function:

75% of Executives
90% of Internal Auditors

Evaluating strategic risk is part of Internal Audits mission:

44% of Executives
58% of Internal Auditors

Internal Audit has a process to identify strategic risk:

47% of Executives
69% of Internal Auditors

Internal Audit has the skills to identify strategic risk:

64% of Executives
85% of Internal Auditors

Internal Audit has adequate funding:

76% of Executives
52% of Internal Auditors

Internal Audit influences organizational strategy

67% of Executives
75% of Internal Auditors

Internal Audit enhances the ability to meet strategic objectives:

69% of Executives
80% of Internal Auditors

Vonya Global surveyed a cross-section of Executives and Internal Auditors from both public and private organizations in a variety of industries to evaluate their opinions regarding the strategic role of internal audit. Many questions in the survey referred to either “Strategic Role” or “Strategic Risk.” For the purposes of this survey we have defined the term “Strategic Risk” as risks that pose a threat to a company meeting its strategic objectives. “Strategic Role” was defined as the role internal audit plays in assessing “Strategic Risk.” The survey asked questions to determine first whether it is internal audit’s role to evaluate strategic risks and secondarily if internal audit is equipped to do so effectively.

The primary goal was to provide a benchmark for Internal Auditors and Executives on the strategic role of internal audit. The survey was open for 4 weeks and available on-line through the Vonya Global website (www.vonyaglobal.com). Respondents volunteered their time and their responses were anonymous. Invitations to participate in the survey were sent through email and a web announcement.

Prior to the survey, we created 4 hypotheses to test. These were based on anecdotal conversations with many Internal Auditors and Executives over the past 2 years.

The first hypothesis was that Executive Management and Internal Auditors do not universally agree on the vision, goal, and objectives of internal audit. The results reveal a general agreement between the two groups, yet there are interesting differences that we will explore.

The second hypothesis, similar to the first, was that there is a slight disconnect between Executives and Internal Auditors on internal audit’s strategic role. We believed that the results would show that the majority of Internal Auditors would view themselves far more strategic than Executive Management. At first glance, when tabulating the results, it appeared as though Executive Management and Internal Auditors were in lock step with each other in regards to the mission and expectations of audit. However, by delving deeper into the answers and reviewing all of the comments it became clear that there is in fact a significant gap.

The third hypothesis dealt with the overall evaluation of the Internal Audit Department’s capacity to serve in a strategic role. The results here were the most revealing in the entire survey and formed the basis for our conclusion. If you read further, you will find that there seems to be agreement between the two groups, yet when comparing the answers collectively a different picture develops.

The fourth hypothesis was on the compliance role of internal audit. Due in large part to Sarbanes-Oxley (or Sarbanes-Oxley-like initiatives), most Internal Audit Departments

Internal Audit helps alleviate the pressure of Executive Management:
67% of Executives
73% of Internal Auditors

Internal Audit would provide more value if not for compliance requirements:
33% of Executives
36% of Internal Auditors

Without compliance requirements Internal Audit would not exist at my company:
24% of Executives
8% of Internal Auditors

have spent a tremendous amount of time working on compliance. We held the opinion that most Internal Audit Departments would like to divorce themselves of the compliance responsibility so they can add value to the company in other, more strategic areas. This hypothesis was proven wrong, but in doing so it revealed some very interesting information.

Throughout the survey, it was apparent that the majority of Executives and Internal Auditors agree that internal audit does not focus on identifying and evaluating strategic risks. Which raises the question, should internal audit focus in this area?

Internal audit's role is to assess risk and evaluate controls. More specifically, the Institute of Internal Auditors (the IIA) defines internal audit as:

*"...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."*¹

The skills required to execute this responsibility have been developed through education, certification, and experience. Millions of dollars have been invested throughout the years to create tools and techniques to assist Internal Auditors with this responsibility. There are associations, peer groups, training courses, conferences and symposia, and libraries established to further the internal audit profession. It is our opinion that the fundamentals of internal audit including all the resources listed above can be applied across many corporate functions, including roles of strategic importance.

Ultimately, there is a gap. This report will shed some light on the potential reasons.

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We have provided quotes from the survey responses throughout this report. These quotes are the opinions of the respondents, are included to provide clarity in the analysis, and in no way reflect the opinion of Vonya Global.

<sup>1</sup> excerpt taken from the IIA Definition of Internal Auditing at <http://www.theiia.org/guidance/standards-and-guidance/ippf/definition-of-internal-auditing/>

## Section 1 - Vision, Goal, and Objectives of Internal Audit

There were four questions that dealt directly with the alignment and expectation of internal audit. As the graphics to the left show, Executives and Internal Auditors mostly agree on Vision, Goal, and Objectives of internal audit.

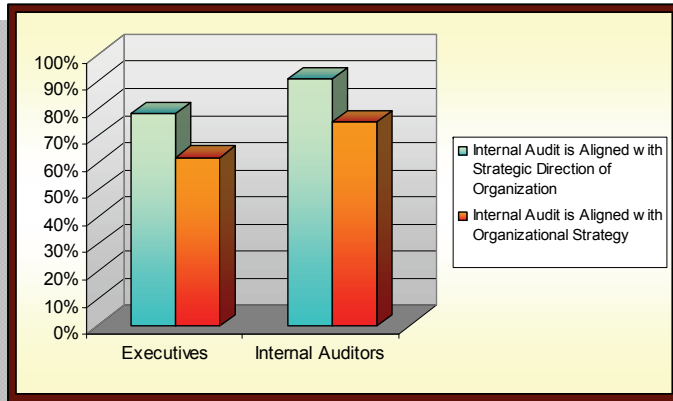
We believe that a large number of Internal Audit Departments at companies today are performing extensive audits that start with the strategic goals of the organization. Most audit directors use a risk based model for creating their audit plan. Many Internal Auditors are involved in various meetings and strategic discussions throughout their day. These discussions help them understand more thoroughly what the goals of the organization are, which are then built into the risk models. Most Executives believe that internal audit's thorough understanding of organizational goals establishes the foundation for a more accurate risk assessment.

It is interesting to note that in each case Internal Auditors are more convinced of the strategic relevance to their role. This result is not surprising as we would anticipate that auditors believe they are in line with the strategic direction of their organization. However, based on several responses and our observations, organizational objectives for internal audit have in recent years been focused on SOX compliance, which limits the capacity for internal audit to serve in a more strategic role.

While the graphics show agreement, there is a disconnection between the two groups by an average of 16%. While 16% is relatively small, part of the disconnection could be how each group defines strategic. What Internal Auditors believe to be strategic like integrity of financial reporting, security of IT applications, and maintaining regulatory compliance is different than what Executives believe to be strategic like investing in Research and Development to create new products, opening new markets to reach a larger client base, and cutting costs to increase earnings per share. It poses a challenge for the two groups to universally agree on the strategic role if there is not a shared definition of what strategic means.

It was interesting that the same question worded slightly different yielded different results as depicted in each graphic. The drop-off was significant, averaging 20% for both Executives and Internal Auditors. We do not have an opinion why this was the case other than the respondents interpreted these questions differently than intended. The following opinions were expressed by the respondents:

*"I believe the internal audit role is substantially removed from the strategic direction of the organization. However, I do believe that the internal audit function supports the growth and best interests of the organization."* - Internal Auditor

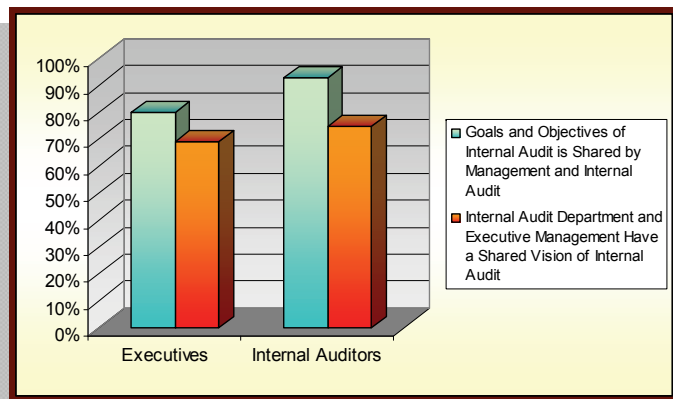


*"The Annual Audit Plan is aligned with the company's strategy. Emphasis is placed on both operations and culture issues as well as significant company goals for the upcoming 12 to 18 months."*

- Internal Auditor

*"The (Internal Audit) department is working directly with the goals and initiatives established by both, the executive management team and the board of directors."*

- Executive



Communication is the key driver for Internal Audit success. It is important for Internal Auditors to regularly meet with Executive Management because initiatives tend to change over time.

*“Management is still learning about the role of a modern internal audit function and the ability of the department to be more than a compliance function. I spend time each month with senior executives providing them with examples of operational observations made during audit activities.”*  
- Internal Auditor

*“1. Attend and participate in the annual strategy setting process. 2. Also attend and participate in the quarterly strategic business reviews. 3. (Identify) which areas of the business “cut-across” the strategic intent of the business, and include those business areas and related upside and downside risks as part of the audit plan.”*  
- Internal Auditor

*“Executive Management relies on and requests specific audits to be performed. At other times, they inform us of areas or risks that may have been newly identified so we can assess if we need to audit the risks in these areas. They review our audit universe and overall risk assessment performed throughout the year. The CEO will ask direct questions regarding issues found in audits when deemed high risk and gets into the detail. The company as a whole, has a clear and shared vision of the value of internal audit.”*  
- Internal Auditor

*“Regular (monthly) meetings with the CEO, CFO and General Counsel enable a clear shared vision of the role of Internal Audit.”*  
- Internal Auditor

*“(Internal Audit) is a necessary planning and operating function. It responds to strategic initiatives; it does not set them.”*  
- Executive

*“(Internal Audit) is not actively included in strategic initiatives even though it is qualified to do so. (Internal Audit) would like to be a more strategic partner.”*  
- Internal Auditor

*“While there is always room for improvement, I believe (Internal Audit) and management have a clear understanding of the responsibilities that (Internal Audit) has been directed to carry out. The opportunity for improvement lies more in the area of assessing the impact of business and strategic risks within the organization. Internal Audit could improve its capabilities in evaluating the effects of strategic and business risk on the overall risk profile of the Company. This would also enhance the primary mission of internal audit to look for potential financial issues.”*  
- Executive

A result we find disturbing and a consistent trend throughout the survey is that 22% of Executives do not think internal audit is aligned with the organization’s strategic direction, and 31% of Executives responded that they don’t have a shared vision of internal audit. While these responses are part of the minority, we find them significant. For example:

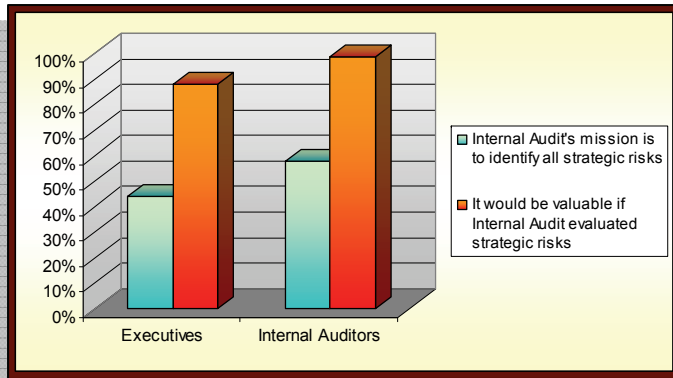
*“CFO does not have an appreciation for what internal audit is about and what it can offer.”*  
- Internal Auditor

*“Too much trivial focus not enough on the important needs.”*  
- Executive

*“Executive management has an antiquated view of auditors and their role in the organization. They are viewed as adversaries rather than partners in strategic initiatives.”*  
- Internal Auditor

We believe that internal audit is and should be viewed as a critical piece to the business. If internal audit, as a critical piece to the business, is not aligned with strategic initiatives or shares the same vision as Executive Management, internal audit will never have a strategic role. Whether this is due to poorly communicated expectations from Executive Management or due to the competency and/or performance of internal audit, it is certain that change is needed. There is an obvious opportunity for internal audit to improve its standing with Executive Management. It starts by better communication, followed closely by understanding the strategic direction of the organization.

## Section 2 - Mission and Value Relative to Strategic Risks



*"The strategy of the organization is taken as given before determining our audit universe and the audit objects."*  
- Internal Auditor

*"...all levels of management from the CEO to area specific managers have input into the audit plan each year. Not only upper management but our customers understand the value of our audits."*  
- Internal Auditor

*"We consider the strategic direction of the organization in our audit planning process based on risk assessment. Additionally, regular meetings with the Audit Committee and the CEO provide input on the direction of internal audit and how internal audit can bring value to the organization."*  
- Internal Auditor

There were four questions that dealt directly with the mission of internal audit relative to the strategic risks an organization faces. There proves to be a significant gap between internal audit's current mission and its potential value as shown in the first graphic on the left. Our basic conclusion is that both Executives and Internal Auditors want internal audit to do more work around evaluating strategic risk.

Executive Management and Internal Auditors were fairly split as to whether the mission of internal audit is to identify all the potentially significant business risks facing a company. This is striking when compared to the rest of the information contained in the graphics in this section.

Specifically, responses indicated that while 78% of Executives believe internal audit is aligned with strategic direction of their organization (as shown in Section 1) and 86% of them believe it would be valuable for internal audit to assess strategic risks, only 44% of Executives state it is internal audits mission to do so. This gap is striking yet similar to the responses from the Internal Auditors.

*"Internal audit focuses on control or where we have been, rather than where we are going."*  
- Executive

*"He understands what we are trying to accomplish, but is having difficult getting beyond SOX to add value."*  
- Executive

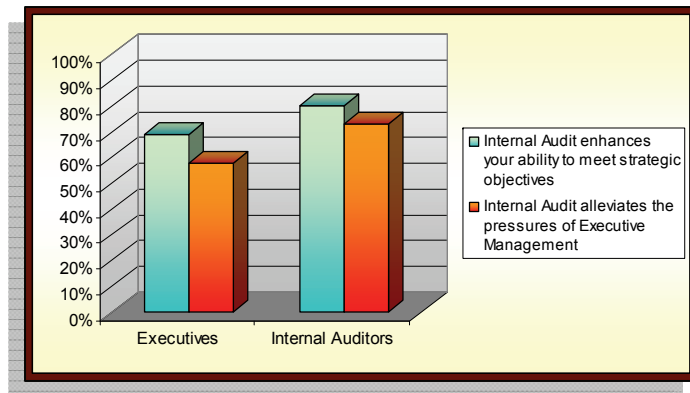
We expected more than 58% of Internal Auditors to respond that identifying all strategic risks is part of their mission, especially when compared to the 99% who responded it would add value to the company. It is understood that internal audit typically focuses on "auditable risks" and many strategic risks are not inherently auditable. However, it is important to note that the question asked about the identification of strategic risks, not the auditing of strategic risks.

For both groups to respond so dramatically, yet consistent with each other, highlights an expectation gap. It appears that the expectation of internal audit from both groups is far less than what is ultimately desired. It is clear that internal audit should be playing a very critical and strategic role for companies. In many cases it does, but clearly not to the level it could.

*"The resource drain to meet compliance virtually eliminates (Internal Audit's) ability to focus resources on risk-reducing audit work. Further, the drain due to compliance work leaves no room for progressive, consultative audit projects. Such consultative audits best support organizational strategic direction by*

*identifying and reducing risk prior to negative effects, thus costing the enterprise less in mitigation costs.”*  
- Internal Auditor

*“We are auditing the critical risks of the organization and ensure that there are processes/procedures in place to mitigate these risks. These critical risks are what may prevent the organization from meeting its strategic goals.”*  
- Internal Auditor

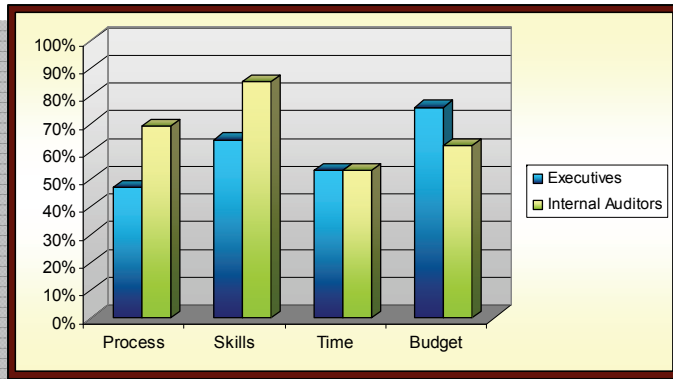


The potential disconnect between the two groups that was identified in Section 1 goes one step further as revealed in the second graphic. Internal Auditors are far more enthusiastic about their role in the company’s overall performance than that of Executive Management. On average, Internal Auditors were 22% more confident than Executives that their work enhances their company’s ability to meet strategic objectives and that they help alleviate the pressures of Executive Management. Based on these responses, it could point back to the definition of strategic as described in Section 1. When compared to the expectation gap identified in the first graphic it becomes obvious that Executive Management would like more from internal audit... *if* internal audit could provide it (“if” factor).

*“I believe that we are a necessary annoying evil in the eyes of senior management (below the CEO and SVP level). We are likely viewed as incompetent and are often ignored. We are not skilled, nor do we try to become skilled, in the forces and risks of the businesses we audit. We do not recruit from the business into audit. We do not have enough knowledge of the details of operations to adequately plan risk or the audits we will perform.”*  
- Internal Auditor

Both groups have strong opinions on the “if” factor and it is explored in the next section.

### Section 3 - Process, Skills, Time, and Budget



There were four questions that dealt directly with the internal audit process, skills, time allotment, and budget, the four main factors enabling internal audit to take an essential role in evaluating strategic risks (the “if” factor). Can one graphic be so revealing? A quick glance at the chart on the left shows a distinct gap in perception between Executives and Internal Auditors.

Internal audit activities begin with a process to identify. While the vast majority of Internal Auditors (69%) indicated that they have an effective process to identify all the potentially significant risks facing the company, less than half (47%) of Executive Management agreed. If this process is not capable of evaluating all of the significant risks to the company, even if they are not auditable risks, the process is incomplete. In the previous section we identified an expectation gap; this graphic takes a step to explain the gap, at least from the executive’s position. The executives in this survey generally don’t believe internal audit has a process to evaluate significant risks, yet 86% see this as valuable. This statistic is significant on its own, but when combined with the information that follows it becomes increasingly revealing.

*“The company’s approach to (Internal Audit) is to pluck persons from various departments in the business and call them auditors. They have no audit background and are not familiar with audit methodology and limited knowledge of risk/control.”*

- Executive

*“I believe that the regulatory requirements hinder the ability of internal audit to perform operational audits due to budget constraints. The SOX and other required audit activities consume too much available time.”*

- Internal Auditor

*“Too much time spent on SOX/MAR control assurance which drastically reduces the resources available to perform risk-based work that more closely aligns with the strategic direction of the organization.”*

- Internal Auditor

Does internal audit have the skills to evaluate strategic risks? 85% of the Internal Auditors surveyed answered “yes” to this question, while 36% of the executives disagree. It is apparent that this group of executives will have a lower expectation for internal audit. This statistic demonstrates the difficulty faced in aligning the expectations of internal audit with Executive Management. Having the appropriate skills, or at least having access to the appropriate skills, is critical. But having the skills is only the first step. It is also important to communicate that these skills are resident in the department and then demonstrate the capability when the opportunity arises.

Roughly 50% of both groups responded that internal audit does not spend an adequate amount of time assessing strategic risks. As a stand alone question it is obvious that Internal Auditors and Executives agree that more time should be spent by internal audit assessing these risks, but when combined with the other responses in this section, one has to question how? From the executive perspective, how can internal audit spend more time assessing strategic risks if internal audit does not have the skills or the processes to do so? Why would the Executives want more from the Internal Audit Department if the Internal Audit Department was incapable of delivering? From the Internal Auditor perspective, if you have the skills and processes to evaluate strategic risks, why are you not dedicating adequate time doing so? Theoretically speaking, there shouldn’t be anything internal audit does to make them less strategic.

While the data compiled in previous sections reveals that internal audit may be aligned with the strategic needs of the organization, the responses in these first 3 questions tend to show otherwise. Based on the responses from Executive Management, Internal

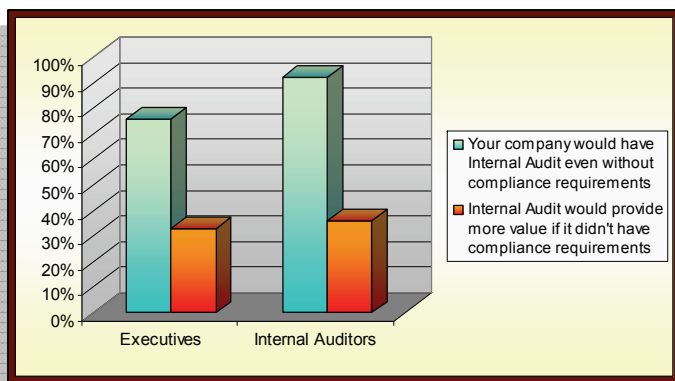
Auditors may not have the talent necessary to identify strategic risks, nor do they have an effective process to evaluate these risks. Why? Is it due to budget constraints? Ironically 76% of Executives believe that internal audit is appropriately funded while 36% of Internal Auditors disagree.

This fourth question when combined with the previous three begins to paint a dire picture for at least a small percentage of Internal Auditors. It appears that some Executives believe that internal audit doesn't have the processes or skills, doesn't spend enough time, but has been provided the budget to do so. Essentially this tells us that some Internal Audit Departments are failing their companies and not fulfilling the potential of strategic internal audit. Conversely, Internal Auditors are claiming that they have the processes and skills so if they had a bigger budget, they could spend more time assessing strategic risks. Each side comes up with the same outcome, "not enough time assessing strategic risks" but take an opposite path to form the conclusion.

We believe that this is significant and further supports the notion that internal audit needs to find more ways to provide value and communicate it to the organization. The optimism among Internal Auditors that has prevailed in this survey seems to be comparatively unrealistic. The responses to these questions highlight a gap that needs to be bridged in order for all Internal Audit Departments to have the capacity to spend more time assessing the risks which pose a strategic threat to the organization.

Keeping the status quo for those in question is not an option.

## Section 4 - Compliance Requirements



Two questions in the survey dealt directly with the compliance requirements of internal audit. In our opinion, the most important and revealing piece to the graphic on the left is what is not readily visible. The first blue bar shows that 76% of Executives would retain the Internal Audit Department even without the need for compliance, while Internal Auditors were higher at 92%. At first glance, this may seem like an appropriate number, but what this really shows is that 24% of Executive Management would eliminate internal audit if it were not for compliance requirements. This bears repeating, 24% of Internal Audit Departments would be eliminated if there were no compliance needs. These Executives obviously do not find strategic value in internal audit.

This would seem to indicate that in order to extend the value of internal audit beyond a basic compliance role, auditors must ensure that internal audit understands and is aligned closely with the strategic goals of the organization. We attribute a percentage of these respondents to organizations that initiated internal audit post Sarbanes-Oxley or are in heavily regulated industries and therefore view its role as strictly compliance oriented. Regardless of the situation, it is imperative for internal audit to demonstrate significant value to their company.

The majority of Executive Management (67%) and Internal Auditors (64%) did not believe that their Internal Audit Department would provide more value if it operated independent of compliance requirements. When combined with other questions, the answers here stand on their own. Executives and Internal Auditors agree that internal audit can not divorce itself from monitoring compliance. Interestingly, this question generated the greatest number of comments, some quite passionate.

One Executive clearly articulated his position about internal audit's role without the need for compliance. In his opinion Auditors do not have the appropriate skills and would have to be trained.

*“By implication, an audit function without compliance requirements would focus on strategic and operational risks. 1) Strategic consulting requires a different set of skills than most audit groups possess. 2) Auditors would require training in strategic consulting. 3) Operational audit frameworks and methodologies would require significant enhancement. Most control frameworks are focused on finance.”*

- Executive

In addition, an internal audit role outside of compliance may cause a level of “boundary crossing” with internal audit getting in the way, “Senior management often has strong incentives to manage strategic risks, so audit may “trip” over management in this effort.”

*“Compliance requirements reinforce the primary purpose of the internal audit function. However, I agree that internal audit departments have the potential to contribute to the risk management process. For instance, special requests to advise or collaborate with others on risk management issues is one way to employ the expertise of the internal audit function.”*

- Executive

*“The Internal Audit department was set up as a result of Sarbanes-Oxley. However, in the absence of this Act, most of the audits would continue to be driven to improve the quality of the financial statement process rather than improving operational effectiveness simply because of the nature of our business.”*

- Internal Auditor

### Methodology

In 2008, Vonya Global distributed a survey to a group of C-level Executives, Executive Management and Internal Auditors. The survey was completed by 155 respondents.

The demographic make-up of respondents includes:

CEO (5%)  
CFO (9%)  
CIO (3%)  
Executive Management (13%)  
Internal Auditors (58%)  
Other (12%)

Respondents reported the size of their company as:

Small-cap (18%)  
Mid-cap (32%)  
Large-cap (32%)  
Private (14%)  
Not-for-profit (4%)

Due to rounding, all percentages used in all questions may not add up to 100 percent.

### Conclusion / Methodology

It is our hope that this document provides a means for Executive Management and Internal Auditors to begin a dialog on the expectations of internal audit, increasing its strategic importance.

Based on the results of this survey, there is good news. The majority of Internal Auditors and Executive Management agree on the role, expectations, and capability of internal audit. However, it is almost universally agreed that Internal Auditors should spend more time assessing strategic risks; therefore, there is room for improvement in almost all cases.

As described in the main body of the report, there is also alarming news. About one third of this survey's population is not satisfied. Internal Auditors and Executive Management have a long way to go before their expectations are perfectly aligned, enabling internal audit to play a more strategic role in the company.

Clearly, alignment is strongly desired by both groups but it remains to be seen whether or not this alignment can be achieved and the gap narrowed. We believe that the foundation of this gap can be found in what is the perceived vision of internal audit. Internal Auditors believe they have the capability to play a far more strategic role for their company, whereas Executives would like to rely upon internal audit more strategically but they are not confident internal audit would deliver.

In our opinion, Internal Auditors could play a far more strategic role within their organization. It is dependent primarily on what the expectation of internal audit is for the organization. Moving the expectation of internal audit to a more strategic role will greatly enhance the perception of internal audit and improve company performance. Bridging this gap will require both groups to take steps in that direction and as with most challenges, communication is key.

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