

Internal Audit – How to Get It Right

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Internal audit (IA) is a little like paying tax. You've got to do it, it takes time and money to figure it out and you can get in lots of trouble if you don't do it right...none of this means that it's fun.

Unlike taxes, however, there are some significant side-benefits to doing it well. That's because IA should properly be viewed as more than just an exercise in making regulators and directors happy. It's a tool of risk management, a way to help you identify and measure and monitor and manage your risks, especially those risks buried in the minutiae of your daily processes and procedures. It helps you take them apart, then figure out where the weak links are. And it helps you assess how well your controls are designed and how effectively they're operating to (cost-effectively) minimize the resulting risks. IA should be viewed as more than just an exercise in making regulators and directors happy. It should be used as an effective management tool.

So...how to do it right? First, it should be risk-based, meaning that it should start with an assessment of where the underlying (or "inherent") risks are. This in turn reflects the type of business your organization does, its structure, staffing, technology, delivery channels – and how all those things have been/are changing. A risk-based approach to IA is one that takes account of all these factors to most effectively allocate your scarce audit resources.

Second, it should be a consultative and collaborative exercise, not confrontational and "gotcha". Auditors should recognize their obligation not just to identify areas of potential concern (i.e., findings) but also how and why they arose and ways the organization might think about correcting the deficiencies. This suggests that no matter how high the auditor's IQ, you need to see a gray hair or two before you can be sure you're really going to get your money's worth. They don't teach experience in college.

Third, an auditor needs to be a communicator. It requires distilling and prioritizing masses of information and passing it along to the client in a meaningful and actionable way. It requires taking a negative message and communicating it more constructively. It requires succinctness for the Audit Committee and step by step detail for the manager charged with corrective action. It requires listening. It requires balancing the needs and interests (and often conflicting agendas) of directors, regulators, senior management and line management.

Fourth, IA must be responsive. This applies whether the audit function is outsourced or internal to the organization. Responsiveness means more than just promptly returning calls or e-mails. It means being responsive to changes in the organization's internal and external environment. Inherent risks change, regulations change, best practices change. An IA practitioner has to be watchful, receptive and flexible.

And finally ... yes, cost matters. Partly this ties back to being risk-based: making sure your audit dollars are being wisely allocated. But it also reflects how your IA activities are structured. Certainly, the larger the organization, the stronger the case to be made for having that function reside in-house. Specialized skills can be hired, organizational familiarity developed and incorporated, audit programs and processes customized. Conversely, the overhead investment that it entails makes less sense the smaller the organization.

As outsourced IA providers ourselves, we'd also point out other considerations that come into play in making that decision. An outside firm offers you an important dose of independence and objectivity; we speak our mind and then move on. An outside firm also gives you a much broader and clearer perspective on standard practice (i.e., what "typical" firms in your industry are doing), as well as of course best practice. An outside firm can bring to the table experts in areas not so important for you to be looking at hiring your own audit expertise – but important enough for you to be sure your risks are being prudently managed. An outside firm is – perhaps paradoxically – generally better able to manage the "consultative" and avoid the "confrontational". We have client relationships, we have competitors. Yes, we also have regulators and others making sure we're not compromising ourselves or cutting corners in the process. But fundamentally ... we're accountable. If an outside auditor misses things and you sustain losses, it won't do much for repeat business, or word-of-mouth. We manage our business accordingly.

To get your internal audit "right", then, you need to start with a risk-based process, you need a consultative and collaborative approach across all constituents, you need to consider costs and establish priorities, and you need a responsive audit partner who can listen and communicate effectively. And although, like taxes, you may prefer not to have to think about internal audit, if you do it right you'll better position your company for success...and that part can indeed be a lot of fun.

For more information or if you have questions please contact:

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