THE POLITICS OF INTERNAL AUDITING

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Sponsored by:
The Institute of Internal Auditors Toronto Chapter
The Institute of Internal Auditors Research Foundation
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The Institute of Internal Auditors Research Foundation (IIARF) continuously monitors the needs of the internal audit profession and its stakeholders to identify priority topics for future research projects. In the spring of 2013, The IIARF requested proposals to perform research on a priority topic: organizational political pressure and the impact on internal audit. The IIARF recognized that internal auditors might face political pressure when it comes to auditing sensitive areas—or reporting results—and that little research had been completed in this area. It sought to determine the extent to which internal auditors face such pressure and to learn how they have handled these situations, both in public and private organizations.

Political pressure is a reality of any organization—large and small; public, private, nonprofit, and governmental; and across industry sectors. Effective chief audit executives (CAEs) must recognize the signs and learn how to manage effectively through political challenges if they are to be persuasive in helping their organizations navigate through risky decisions, or even in reporting audit results in the face of significant challenges. Internal audit organizations cannot fulfill their key goal of helping their organizations achieve objectives without astute internal audit leaders who can navigate the formal and informal power structures that exist.

However, defining what is political versus what is a decision you simply disagree with requires judgment and experience. This project seeks to gain an understanding of how effective CAEs identify political pressures and overcome, or at least effectively manage, them.

We hope that this specific report offers helpful insights, suggestions, and useful examples for internal audit leaders. Although the primary audience is new and experienced CAEs, we anticipate that boards of directors, audit committee members, executives, and internal audit practitioners will all learn from this research and understand their role in helping the CAE through political challenges.
This research project was envisioned and funded by The Institute of Internal Auditors Research Foundation (IIARF), and overseen by the Committee of Education and Research Advisors (CREA) under the leadership of Chairman Urton Anderson. We appreciate the CREA Review Team—Steve Goodson (team lead), Joe Bell, Karin Hill, Ken Jenkins, and Jie Ju. We are also grateful to IIARF Board of Trustee project champions Phil Flora and Jacques LaPointe.

We are thankful for the active and specific contributions of the 23 chief audit executives (CAEs) who graciously shared their experiences related to the topic of organizational political pressure with complete candor. Further, they thoughtfully discussed the lessons they learned, insights, and suggestions for other CAEs. We also sincerely appreciate those CAEs who took the time to attend the focus group and participate in our survey.

We are grateful to Patty Miller and Dr. Larry Rittenberg for their role in performing this research, analyzing the results, and preparing this report. Last, but not least, we appreciate the assistance of key Institute of Internal Auditors (IIA) staff personnel at global headquarters in Altamonte Springs, Florida, United States—especially Deborah Poulalion and Lillian McAnally.

—Frank O’Brien
President,
The Institute of Internal Auditors Research Foundation
About the Authors

Patricia K. Miller, CIA, QIAL, CRMA, CPA, CISA, has experience in the areas of governance, risk management, and internal control, with significant consulting and managerial experience in finance, accounting, internal auditing, and risk management areas. She is currently an executive-in-residence for the University of Nevada-Reno, and teaches a graduate course in internal auditing. Her consulting business, PKMiller Risk Consulting, LLC, assists clients in the areas of governance, risk management, and internal auditing.

Patty spent 14 years with Deloitte & Touche LLP in the (San Francisco) Bay Area, serving as the lead risk services partner on some of the firm’s most significant technology and consumer business clients, providing internal audit, risk management, control consulting, Sarbanes-Oxley, and related professional services. In this role, she advised clients and audit committees on governance, risk management, and internal control leading practices. Patty also led the Deloitte & Touche national risk management function for internal audit services, providing consultation to other engagement partners on engagement quality and risk management. Patty joined Deloitte & Touche following a 14-year career with Pacific Telesis and Pacific Bell (now AT&T) where she held numerous mid- and senior-management positions in diverse areas including financial management and planning, billing, internal audit, process design and reengineering, project and program management, and merger planning and integration.

During her tenure with Deloitte & Touche, she was nominated and elected to serve on the global Board of Directors of The Institute of Internal Auditors (IIA), including serving as a member of the Executive Committee for seven years and as chairman of the board from 2008–2009. In this role, Patty traveled internationally representing The IIA in meetings with regulators, stakeholders, and key internal audit leaders. She currently chairs the International Internal Audit Standards Board.

Patty has also published two important IIA Research Foundation reports. The first, Sarbanes-Oxley Section 404: Looking at the Benefits (2005, with Larry Rittenberg), was one of the first research projects that
measured and identified the benefits associated with the implementation of the U.S. Sarbanes-Oxley Act of 2002 and its emphasis on internal controls. The second project, *Insight: Delivering Value to Stakeholders* (2011, with Tara Smith), focused on interviews with leading CAEs across the globe to better define “insight,” as well as how leading internal audit departments were delivering results-oriented audits that provided management and the board with insights on the root causes of significant findings and how such findings could be addressed. It won The IIARF’s Larry Sawyer Research Foundation Project of the Year award.

**Larry E. Rittenberg**, PhD, CIA, CPA, Professor Emeritus, University of Wisconsin, Chair Emeritus, COSO, has taught the past 38 years at the University of Wisconsin in the area of auditing, IT auditing, corporate governance, and risk management. During that time, he has been an active member of The Institute of Internal Auditors (IIA). He has served as president of The Institute of Internal Auditors Research Foundation (IIARF), member of the International Professional Practices Oversight Committee, global vice-chair of Professional Practices, member of the Board of Trustees of The IIARF, and member of the Education Committee. He played an active role in developing the Vision for the Profession in the late 1990s, including the drafting of the current definition of internal auditing. During that time, Professor Rittenberg also wrote numerous articles and research monographs related to internal auditing and risk management, including, among others, *The Outsourcing Dilemma: What’s Best for Internal Auditing* (1997, with Mark Covaleski) and *Sarbanes-Oxley Section 404: Looking at the Benefits* (2005, with Patty Miller), and more recently *COSO, Internal Control – Integrated Framework: Turning Principles Into Positive Action* (2013).

Dr. Rittenberg became the chair of the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in January 2005 and served in that role through 2009. He continued to serve on COSO as Chair Emeritus and as a member of the Internal Control Task Force through 2013. Under his leadership, COSO issued guidance on implementing internal control over financial reporting for smaller public companies (July 2006), monitoring the effectiveness of internal control (2009), and fraudulent financial reporting (2010). He played an instrumental role in the development of the Enterprise-Wide Risk Management framework issued by COSO in 2004. He also led the organization in developing a strategic plan aimed at providing more timely guidance on internal control, governance, and risk management around the world.
Dr. Rittenberg currently serves on the Board and Chair of the Audit Committee of Woodward, a NASDAQ public company with approximately $2 billion in revenue. He previously served on the Audit Committee of Petro China, the largest company in China, and advised them on issues related to enterprise risk management and internal control over financial reporting. He has worked with finance ministries in China and Japan to develop their standards for internal control. Professor Rittenberg was recognized in "2005’s Influencers: 50 Worth Watching" by Business & Finance Journal, January 2005, as one of the 50 most important accounting influencers in the country. He was also recognized as “One of the Most 100 Influential Individuals in Finance” by Treasury & Risk magazine (2007).
EXECUTIVE SUMMARY

INTRODUCTION AND BACKGROUND

“Organizational politics is usually defined as behavior strategically designed to maximize self-interests (Ferris, Russ, & Fandt, 1989) and therefore contradicts the organizational goals or the interests of other individuals.”

“The essence of politics...is the acquisition and exercise of power, either formally or informally.”

Organizations are, by definition, political. They are composed of people who have different individual goals and objectives, different value systems, different approaches to accomplishing their objectives, and who are motivated by different types of reward systems. Even without the broad mission of internal auditing there would be political pressure. But given the unrestricted scope of internal auditing and the reality that internal audit results may reflect badly on some individuals—or bring attention to issues that some would prefer not be shared—the potential for political pressure on chief audit executives (CAEs) is great.

This research report addresses the issue of political pressure on CAEs and their internal audit departments. We first identify the types of political pressures encountered by CAEs. We then turn our attention to how effective CAEs work to mitigate political pressure, and then to lessons that can be learned that may assist others in managing political pressure.

Based on the results of our interviews and related research, we define organizational political pressure in a negative fashion as it relates to internal auditing as:

“The situation in which individuals in leadership positions exercise their authority to achieve a personal benefit, or to protect an organization, by attempting to manipulate the internal audit activity or internal audit reports. Such manipulation may result in actions to restrict the scope of
audit activities, suppress audit findings, or undermine the credibility of the chief audit executive or the internal audit activity.”

An effective CAE must recognize the signs of political pressure and learn how to navigate effectively through political challenges to accomplish internal audit’s mission and add value to the organization. Internal audit must have the ability to address risks with unrestricted access, with objectivity and fact-based evidence, and in uncensored reports (no matter their content—positive or negative) addressed to executives and the board. And they need to do this even in the face of significant challenges, including those posed by political pressure.

Making the distinction between what constitutes political pressure and what is a decision or action with which one simply disagrees requires judgment and experience. Given this nuance, there is a need for research into how CAEs meet this everyday challenge. Our objective is to learn from real experiences and discover leading practices for dealing with political pressure gleaned from interviews with leading CAEs from around the world who operate in public and private sectors and large and small organizations.

How big of an issue is political pressure? From a survey we conducted of about 500 CAEs, we discovered:

- 54.7% of the respondents said they were directed to omit or modify an important audit finding at least one time, with 17.2% indicating it happened three or more times.
- 49.0% were directed to not perform audit work in an area that the CAE viewed as high risk.
- 31.5% were directed to perform work in a low-risk area so that an executive could investigate or retaliate against another individual.

Further, at a focus group of leading CAEs attending ‘The Institute of Internal Auditors’ (IIA’s) 2014 General Audit Management (GAM) Conference, 100% indicated they had experienced political pressure, and a little more than 25% said they left a position because of the political pressure on internal audit.

We interviewed CAEs who lost their jobs, were forced into early retirement, or were demoted within the organization. Both the threat and the actuality of political pressure are real.
RESEARCH APPROACH

Our research objectives were to clearly define political pressure related to internal audit and gain insights and leading practices from CAEs who have dealt with political situations. We used a triangulation approach to our research. See exhibit 1.1.

- Interviews with CAEs (our major focus)
- Focus group with CAEs (24 CAEs attending GAM)
- Survey of CAEs (responses from approximately 500 CAEs who were members of The IIA in North America)

Our initial approach focused on interviews with CAEs across a broad cross section of organizations—large and small; public, private, and governmental; in North America and in a selection of developed nations outside North America. We conducted in-depth interviews with 23 CAEs who shared personal experiences from 25 organizations where they had worked during their career. Of those 25 organizations, 18 (72%) were headquartered in North America (the United States and Canada). The remaining organizations were headquartered in Asia, Europe, and Africa. The research focused on gathering insights and sharing those insights rather than testing hypotheses. Due to the nature of the discussion, the
identities of the individuals interviewed and the organizations where the political pressure was alleged to have been exerted are confidential. A summary profile of the individuals and the organizations is included in section 2.

The focus group was held coincident with the GAM Conference in March 2014. We used electronic polling and facilitated discussion with 24 internal audit leaders who were selected based on their industries and known leadership. The purpose of the focus group was to test the initial insights and tentative conclusions drawn from our interviews. The focus group corroborated most of our earlier findings and offered additional insights that helped shape our research.

The survey was sent to CAEs in The IIA’s North American membership database in June 2014. We received 494 responses to questions that were based on our structured interview results. The survey allowed us to quantify the frequency of political pressure and provided a greater ability to understand whether political pressure differed along dimensions such as the size of the internal audit function, industry, traditional CAE versus rotational CAE, and others.

**KEY CONCLUSIONS**

We grouped our conclusions along two dimensions: 1) research findings about the extent of political pressure in internal auditing, and 2) lessons learned, as articulated in interviews and corroborated through our focus groups and online survey.

**RESEARCH FINDINGS**

1. **Political pressure on CAEs is extensive and pervasive.** As noted earlier, more than half of our survey participants (55%) had been subjected to pressure to omit or modify a finding; the vast majority (71%) noted the pressure was due to a concern that the report would reflect badly on key operating management. Further, almost half (49%) were directed to not audit a high-risk area, usually by an executive in the organization (80% of responders said the request was from executive management). CAEs with impeccable service records in both the private and public sector lost their jobs or were encouraged to take other positions or early retirement for challenging management on political issues.
2. **Political pressure comes in many forms.** Some political pressure is not very subtle, e.g., physical threats (yes, personal threats were described in our interviews) or loss of jobs. But pressure can be more subtle, e.g., loss of staff, decrease in the internal audit budget, CAE transfer to a lower-level position within the company, or a CAE encouraged to take an early retirement.

3. **Good corporate governance is crucial.** It is difficult for internal audit to be better than the underlying organizational culture and governance process. The need for effective corporate oversight (board and audit committees) was emphasized in the Committee of Sponsoring Organizations of the Treadway Commission’s (COSO’s) *Internal Control – Integrated Framework* in 1992. However, as described to us, some organizations do not have effective audit committees, and many governmental and private organizations do not have audit committees at all—or the ones they have are chaired by the organization’s CEO.

4. **Political pressure can be managed and partially mitigated, but it always exists.** Political pressure might be analogous to a latent disease; it exists, but the internal audit strain can be kept dormant by highly effective CAEs. However, it requires a competent CAE, a sound internal audit function, a clear understanding of the business, conclusions based on factual evidence, and respectful relationships with executives and the board.

5. **Professional competence is required, but it is not sufficient.** Ineffectual CAEs may be pressured to change findings or suppress reports because of inaccurate or overstated findings. However, we found that a number of effective CAEs and audit teams with a high level of technical competence and professionalism were still subject to political pressure. Internal auditors must understand that there is a difference between genuine disagreements and political pressure. All CAEs, no matter how competent or professional they are, must also be politically astute to anticipate and successfully manage political pressure.
6. **Organizations, technology, and organizational objectives change.** CAEs must invest in change, whether the change is in the business environment, technology that allows internal audit to do more with the same resources, or continued investment in skills. Stated differently, the internal audit function cannot rest on “doing what it has always done” and expect to avoid political pressure. Organizations are constantly moving and changing. Internal audit must invest in change, whether it is building a better core staff or making better use of technology to perform audits. Richard Chambers, president and CEO of The IIA, describes the challenge as "Auditing at the Speed of Risk."

7. **Political pressure exists whether the CAE position is career-focused or rotational.** We did not find any empirical evidence that would support a conclusion that one approach or the other is best at mitigating or avoiding political pressure. Academic research has raised questions regarding a rotational CAE. However, through our interviews and observations we noted that many organizations that move to a rotational CAE are doing so because the previous CAE was not necessarily keeping up with organizational change, and that many rotational CAEs are astute at identifying and managing potential conflicts.

**LESSONS LEARNED**

Fortunately, our interviewees and focus group leaders shared sound advice that will be helpful for CAEs in avoiding or mitigating political risks. Part of the advice is to perform internal audit risk management, i.e., understand the risks in the environment that might affect the internal audit function (for example, understanding changes taking place within the organization or understanding the multiple ways in which political pressure might manifest itself). We expand on “Lessons Learned” below and throughout this report.

1. **Build relationships.** Most successful CAEs felt that building strong relationships, particularly with executive management and the audit committee chair, was extremely helpful. Although such relationships
might not solve all problems, the CAE who builds the trust of the key people will fare much better.

2. **Understand the culture of the organization.** Many CAEs were surprised at how quickly an organization’s culture can shift with a change to executives who may be more attuned to the “short-termism” of the market or the need to meet other organizational objectives. They also reported instances where certain top executive behaviors quickly became acculturated throughout the organization, and previously unacceptable behaviors became acceptable.

3. **Business acumen and judgment is needed.** To demonstrate value, earn respect, and build credibility, the CAE and the internal audit function must demonstrate a sound knowledge of the business and apply that knowledge in assessing risk. Internal audit needs to align its efforts with the organization’s direction, while never compromising professionalism or objectivity, and demonstrate sound judgment by fairly evaluating the significance of audit findings. Effective CAEs have the ability to convey audit findings from management’s perspective, rather than a narrower internal audit perspective.

4. **Focus on shared objectives.** Many CAEs pointed out that understanding the position and potential motivation of the individual applying political pressure and focusing on shared objectives for the organization (e.g., “we are on the same team”) helped them to better frame an issue in a way that the other party understood—and often kept something that could be big from expanding. It was also noted that when internal auditors actively participate in key organizational initiatives (such as cost containment, quality improvement, and Six Sigma initiatives) by enthusiastically implementing such programs within internal audit (versus just auditing to see if others are complying), they visibly demonstrate that they are “on the same team.”

5. **Build a strong internal audit charter and foundation.** Audit committees of public companies within the United States are required to have oversight of the
internal audit function. Internal audit functions need a clear and detailed charter that specifies reporting relationships, authority, unrestricted access, and other key expectations and responsibilities. Such a charter can be used to discuss and diffuse pressure exerted by misinformed senior managers who do not fully appreciate internal audit’s role.

6. **Know your limits (and be courageous).** Most CAEs felt there was a clear line past which they could not budge. They knew their personal value system and were willing to risk losing their jobs if it meant taking the right professional actions. As reported to us, caving to political pressure causes a loss of internal audit credibility and paves the way for more pressures in the future.

7. **Staff the audit function to add value.** Whatever staffing philosophy is used, it is crucial that the internal audit staff is competent, professional, understands the business, and communicates effectively. Such a staff will give the CAE comfort in knowing that he or she is dealing with facts, and will radiate a positive image of internal audit throughout the organization. Leading internal audit functions have a clear strategy for managing and hiring professional, confident auditors.

8. **“Facts are your friend.”** This phrase emerged repeatedly during our interviews. The CAEs emphasized the importance of objectivity, accurate and complete data, thorough audit work and analysis, and an astute understanding of the effect of the finding on the organization. This phrase resonated loudly in our interviews with both the “rotational CAE” as well as the “career-oriented CAE.”

9. **Maintain composure.** Many CAEs cited this as a critical attribute for effectiveness. They emphasized that the CAE cannot take the pressure personally, and the entire internal audit management team needs to show poise in tense situations.

10. **Anticipate political pressure.** Being proactive in addressing potential political pressure requires the CAE to identify the attributes and criteria that could lead to
a “stand-your-ground” decision on important issues. Some CAEs described decision models they developed to help them judge the significance of an issue. Further, they identified the key people in the organization with which to discuss such issues should they arise. For example, they discussed the role of internal audit in the organization as well as various scenarios with the audit committee and the executives, and specified the support they would expect. Many commented that the best time to clarify the support they needed was upon accepting the position.

11. **Self-reflection.** Most CAEs felt they learned from political experiences—what went well and what did not. The reflection should identify new opportunities to mitigate political pressure by better understanding the other individual’s point of view, ensuring both the facts and the interpretation of the facts were germane, and whether internal audit fully understood the context of the pressure and the audit findings.