Journal of Business, Economics & Finance ISSN: 2146-7943

Journal of Business, Economics & Finance
Year: 2013 Volume: 2 Issue: 1

INTERNAL AUDIT POSITIONING - FOUR STAGE MODEL

Aslı Yüksel Mermod [1], Gökhan Sungun [2]

[1] Teaching Professor at Marmara University, Turkey.
[2] PhD Candidate, Institute of Social Sciences, Marmara University, Turkey.

KEYWORDS

Positioning of internal audit, maturity of internal audit, competency of internal auditors, internal audit in Turkish companies.

ABSTRACT

The objective of this paper is to introduce a new model about positioning of internal audit. There are only a few studies about this subject. Studies about positioning of internal audit function are made for individual research subject such as internal audit's position in public companies, in private companies, in big firms, in a country, etc. However, there are not many models which show dynamics of internal audit function with a macro approach for positioning as to its maturity, skill sets, independence and governance for private industrial companies. The positioning model outlined in this paper aims to contribute to literature by providing a generic guideline and a tool for assessing the position of any internal audit function and to increase the awareness among stakeholders; thus, motivate decision makers of Turkish organizations to interrogate and challenge what they should be expecting from internal audit function. It will also help the Chief Audit Executives to make more effective audit planning, budgeting, staffing, training, and execution.

1. INTRODUCTION

As defined by the Institute of Internal Auditors (IIA), internal auditing is 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.

In parallel to the economic developments in the world, the internal audit profession has evolved. At the early twentieth century, the internal auditor was seen as a verifier, or a "detective," to protect organizational assets, focusing on only financials. Over time, internal auditors became heavily involved with operational audits, internal controls, risk management, governance and IT concepts. Thus, in addition to their assurance duties, internal auditors started to give consultancy services which became quite popular until the global economic crisis in 2001. After the passage of the Sarbanes-Oxley Act (SOX) in 2002, internal auditors were redeployed to help their companies comply with the documentation and testing of internal controls required under Section 404. As compliance with Sarbanes-Oxley requirements became largely routine, a balanced approach has started to be applied. As indicated in one of Ernst and Young's reports in April 2011, 'internal

audit is undergoing its second transformation in a decade' (Tapestry Networks, Ernst & Young, 2011).

As aforementioned, the positioning model outlined in this paper aims to contribute to literature by providing a generic guideline and a tool for assessing any internal audit function and to increase the awareness level among stakeholders; thus, motivate decision makers of Turkish organizations to interrogate and challenge what they should be expecting from internal audit function.

The remainder of the paper is organized as follows. In the second section, Four Stage Model conceptual framework is described. Following the conceptual introduction, further insight and calculation mechanics of the model are provided. Then, conclusive remarks are made at the end.

2. FOUR STAGE MODEL - CONCEPTUAL FRAMEWORK

Studies about positioning of internal audit function are made for individual research subject such as internal audit's position in public companies, in private companies, in big firms, in a country, etc. However, there are not many models which show dynamics of internal audit function with a macro approach for positioning as to its maturity, skill sets, independence and governance for private industrial companies. Literature search on this topic reveals that there are two studies made that have some positioning concept and some similarities to the model presented in this paper.

The first study is made by the Institution of Internal Auditors (IIA) Research Foundation that published the Internal Audit Capability Model (IA-CM) for the Public Sector in 2009. The developed model by the IIA is intended for self-assessment, capacity building, and advocacy under two phases; overview and application. The IA-CM provides a framework for assessing the quality, impact, cost-effectiveness of an internal audit activity and for identifying the fundamentals needed for effective internal auditing and describes the levels and stages through which internal audit activity can develop and improve processes and practices. The IIA model consists of five progressive capability levels, each describing the characteristics and capabilities of an internal audit activity at that level. As indicated in the website of the IIA, the levels are as follows (IIA Research Foundation, 2009):

Level 1. Initial - No sustainable, repeatable capabilities; dependent on individual efforts.

Level 2. Infrastructure - Sustainable and repeatable internal audit processes.

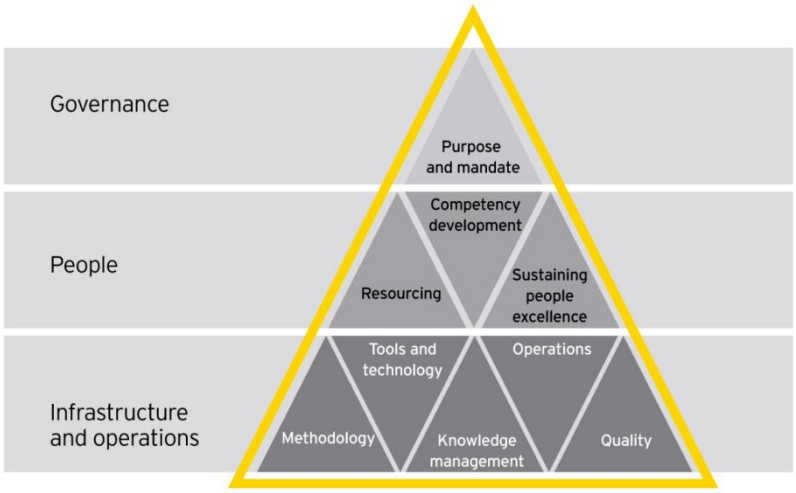
Level 3. Integrated - Internal audit and professional practices uniformly applied.

Level 4. Managed - Internal auditing integrates information from across the organization to improve governance and risk management.

Level 5. Optimizing - Internal auditing learns across the organization to improve governance and risk management from inside and outside the organization for continuous improvement.

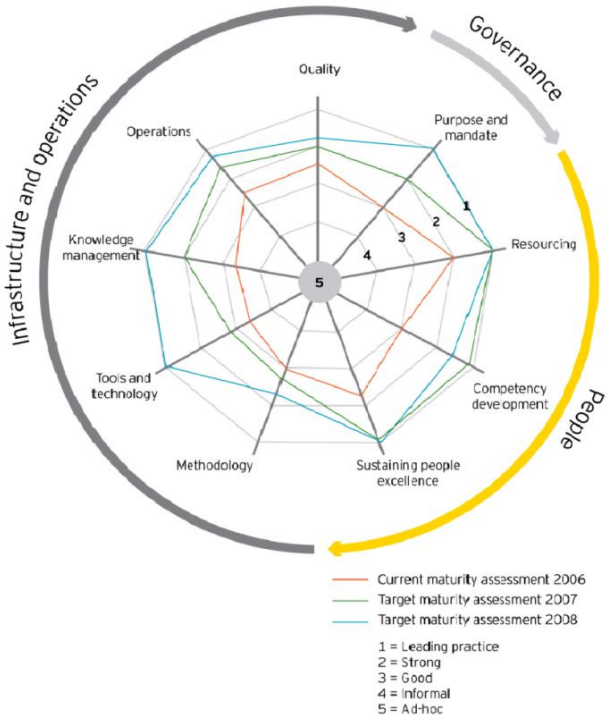
The second study is made by Ernst & Young, in conjunction with the Rio Tinto Corporate Assurance function that has developed a sophisticated maturity model that can help assess internal audit function performance. This model starts with three primary considerations – governance, people and enablers – which expand into nine building blocks of a successful internal audit function: operations, quality, knowledge management, tools and technology, methodology, sustaining people excellence, competency development, resourcing, purpose and mandate (see Figure 1). Reviewing any internal audit function against the model's behavioral criteria reveals current maturity level for each building block which helps to develop an action plan (see Figure 2) (Ernst & Young, 2009).

Figure 1: The Maturity Model



Source: Ernst & Young, 2009, Metamorphosis, Part 2.

Figure 2: Spider Diagram of Maturity Gaps

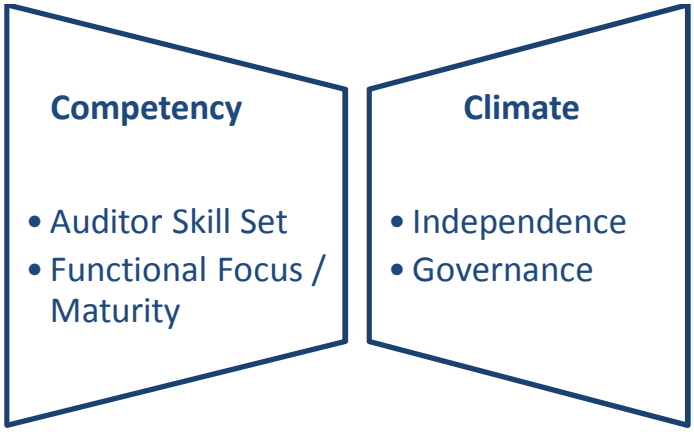


Source: Ernst & Young, 2009, Metamorphosis, Part 2.

On the other hand, the following model presented in this study aims to represent a macro and generic easy-to-use positioning tool that provides the internal audit profession a measure to assess and compare different internal audit functions with a scientifically researched benchmark of their status and competency qualities among them. Understanding and benchmarking the position of internal audit function of any organization and acknowledging the capabilities and maturity of the function will help the decision makers and responsible people to determine right actions for more effective internal audit function. Therefore, this model is expected to be used as a tool to help audit executives and the Board of Directors to create appropriate action plans in order to develop /improve their audit functions and add value as the ultimate goal.

The model is called 'Internal Audit Positioning Four Stage Model'. Positioning the four stage model has two components; "Competency" and "Climate". And the subcomponents of competency are set as "auditor skill set" and "functional focus/maturity" while the sub-components of "climate" are set as "independence" and "governance". The relationship matrix of the components is shown in the figure below:

Figure 3: Subcomponents of Competency - Climate Relationship Matrix



Each subcomponent is explained in Section 3 in detail.

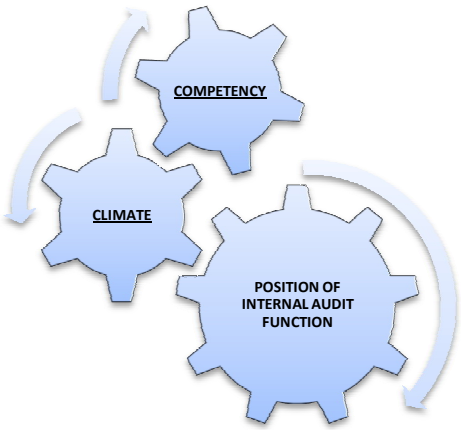
The Model is a multi-dimensional assessment tool that can help all the stakeholders determine how their internal audit function is positioned among a spectrum of characteristics as outlined in Section 4.

With respect to the components mentioned above, positioning internal audit function consists of all sub-components as shown below:

Figure 4: All the Dynamics of the Positioning Model at a glance

In evaluating individual internal audit functions, there are many models or evaluation methods in the literature that considers only one dimension at a time which is mainly related with the competency of internal auditors or the audit scopes (what type of audits are conducted in which areas). On the other hand, this Model presented here assumes that in order to evaluate an internal audit function, all the required elements of an effective internal audit function need to be incorporated in a single platform in a multi-dimensional way. These elements or measurement components are auditor skill set, functional focus/maturity, independence and governance. These elements are further grouped under the headings 'competency' and 'climate' as follows: Auditor skill set and functional focus/maturity which are the two hard measurement components make up the competency component while independence and governance which are the two soft measurement components make up the climate. Depending on where an internal audit function lies in a spectrum of competency and climate component measurements grid, the positioning is determined (this is explained in section 4 with an example). Thus, the situational marking of competency and climate identifies the position level of the internal audit function as shown below:

Figure 5: The Two Components of the Positioning Model



This assessment tool is intended for audit functions of any size and any industry. It helps stakeholders to determine where their function falls across a range of positioning levels so that it guides audit functions to work towards moving into the desired positioning. The measurement components used within the model are derived from various white papers, IIA recommended practices and published researches.

3. FOUR STAGE MODEL - FURTHER INSIGHT

3.1. Competency

The first one of the two main components of the model is named as 'Competency'. A competency is a set of defined behaviors and skills that provide a structured guide enabling the identification, evaluation and development of the behaviors in individual people / function / department / unit / etc... 'Some scholars see "competence" as a combination of knowledge, skills and behavior used to improve performance; or as the state or quality of being adequately or well qualified, having the ability to perform a specific role' (Ensel E., O'Neal E., Stelzer M., Testa D., 2012). As outlined in Wikipedia also, competency is used as a more general description of the requirements of human beings in organizations and communities.

In this context, the 'Competency' component in the model represents the same concept over specific internal audit function being analyzed. Its subcomponents are 'Auditor Skill Set' and 'Functional Focus / Maturity'.

3.1.1 Auditor Skill Set

As indicated by Neelakantan: Internal Audit teams, normally, are set up as a separate department with no operational responsibilities, a practice followed to ensure independence. Traditionally, personnel in these functions are limited to accounting and finance background, and not necessarily with expertise in process and performance improvement tools. Having a right mix of personnel with experience in operations, management, financial analysis, process evaluation, performance tools and business excellence models would serve well to set up a team which can complement each other's capabilities and work towards serving the common objective of establishing the Internal Audit function as a model for sustained business improvements (Neelakantan K., 2011).

The Institute of Internal Auditors (IIA) developed an Internal Auditor Competency Framework that identifies several key skills divided across the following knowledge areas – Interpersonal Skills, Tools and Techniques, Internal Audit Standards, and Theory, and Methodology. Individual components within these knowledge areas are vast (Berry R., 2012).

According to the IIA Australia's Competency Framework of Internal Auditors which was developed to answer a need in Australia for well trained internal auditors and adapted from existing competency frameworks developed by IIA Global and IIA UK and Ireland, competencies outline the critical behaviors required for effective performance as an internal auditor and provide the basis for a broad range of practices including recruitment and selection, reviewing performance, training and development, talent management and succession planning as can be seen in Table 1 below.

Table 1: Internal Auditor Competency Framework issued by the IIA Australia

Standards	Technical Skills	Interpersonal Skills	Knowledge Areas
The International Professional Practice Framework (IPPF)	• Research and investigation • Business process and project management • Risk and control • Data collection and analysis • Problem solving tools and techniques • Computer aided auditing techniques (CAATS)	• Influence and communication • Leadership and teamwork • Change management • Conflict resolution	• Financial and Management • Accounting • Regulatory, Legal and Economics • Quality and control • Ethics and fraud • Information technology • Governance, Risk and Control

Each competency area above is described in terms of the behaviors required to perform effectively across four different job levels. These levels are: (1) New Internal Auditor, (2) Practising Internal Auditor, (3) Internal Audit Manager, (4) Chief Audit Executive.

Core Competencies for Today's Internal Auditor, is one of five deliverables of The IIA's Global Internal Audit Survey: A Component of the CBOK Study which is the most comprehensive study ever to capture current perspectives and opinions from a large cross-section of practicing internal auditors, internal audit service providers, and academics about the nature and scope of assurance and consulting activities on the profession's status worldwide. It identifies the attributes of an effective internal audit activity and what internal auditors really need to know to perform their jobs with due care while adding value to their respective organizations. The analysis is based on 13,582 responses of IIA members and nonmembers in more than 107 countries (IIA Research Foundation, 2010).

The survey noted that the following core competencies were highly ranked for all levels of the internal audit activity (staff, management, and Chief Audit Executive).

- Communication skills
- Problem identification and solution skills
- Keeping up to date with industry and regulatory changes and professional standards.

The survey considered technical skills very important and ranked them in the following order:

- Understanding the business
- Risk analysis and control assessment techniques
- Identifying types of controls

The following knowledge areas are considered very important and ranked in the following order:

- Auditing
- Internal audit standards
- Ethics

- Fraud awareness
- Enterprise risk management

The following were the highest ranked audit tools and techniques:

- Risk-based audit planning
- Other electronic communication
- Analytical review
- Statistical sampling
- Electronic work-papers

The survey predicts that computer-assisted audit techniques will replace statistical auditing in the next five years in the list of top five audit tools and techniques. In addition, internal auditors predict the use of data mining and continuous/real-time auditing will significantly increase over the next five years (Nissley E., 2011).

According to a recent survey by the Institute of Internal Auditors (IIA), corporate internal-audit work this year will focus on operating risks the most (over 25% in comparison with compliance risks that make up 15% and Sarbanes-Oxley testing that make up 12%). The IIA survey, based on a survey of 461 internal-audit professionals who work for Fortune 500 companies based in North America, the following are the top five skills sought for new internal auditors:

1. Analytical and critical thinking (73%)
2. Communication skills (61%)
3. Data mining and analytics (50%)
4. General IT knowledge (49%)
5. Business acumen (46%)

'IIA president and chief executive officer Richard Chambers notes that companies are looking beyond the finance department for potential internal auditors. "The ability to mine and analyze data has been high on the list for the last couple of years," he says. The IIA has been insisting in recent years that the internal-audit profession has moved away from acting solely as finance and compliance cops and now must act as advisers and experts who can opine on broader matters, including strategic risks to the business' (Johnson S., 2012).

As the expected skill set for internal auditors in the year 2015, Deloitte has the following comments: 'The one skill the Internal Auditor should focus more on in the future is business insight. All parties, including the Internal Auditors, recognize this. Real business insight is still found to be lacking. This is the most important framework the Internal Auditor should benchmark his observations/recommendations against (next to the Internal Audit standards of course). Communication skills (orally and written) in terms of final reporting (to Executive Management and Audit Committee) but also during the project/audit (to convince and gain respect from operational management) and focus on a limited number of real business risks, is something Executive Management and Audit Committee members consider very important and should get more attention towards the future. Finally, more focus on IT skills (whether or not outsourced) is a common view of all included parties' (Deloitte, 2009).

3.1.2 Functional Focus / Maturity

In recent years, the role of internal audit functions has increased significantly following a number of major corporate scandals and the financial crisis which stressed the need for a better, more comprehensive view of the internal and external risks faced by organizations. In response, PwC has developed the Internal Audit Maturity model, with the objective for organizations to review and improve their existing internal audit functions. This model is based upon a set of attributes (role, scope, quality and spend) and measures these against various maturity levels (immature, established, performing and leading), as described below (Wery P., 2012).

The four attributes in the Model can be summarized as follows:

1) Role of the Internal Audit Function: This attribute refers to the relationship between an organization's internal audit function and its senior management, along with the organization's level of human capital investment into its internal audit function. At the top end of the model, the members of a "leading" internal audit function will report directly to those charged with governance, including senior management and those outside senior management (i.e. non-executive directors), to give them a clear and comprehensive picture of the risks faced by their organization. "Immature" internal audit functions are at the bottom end of the maturity model and their role is limited. In such a configuration, there are few lines of communication between senior management and internal audit, meaning that those responsible for governance will have little awareness of the risks their organization faces.

2) Scope of the Internal Audit Function: The "scope" essentially relates to the approach taken by the internal audit function in performing its work, to the risk level covered and to the overall goals the internal audit function aims to achieve. Leading" internal audit functions provide dynamic risk assessments which cover a full spectrum of risks and which are based on various internal and industry factors. At the bottom end of the model, the scope of "immature" internal audit functions largely depends on available resources, and such functions are unlikely to have sufficient dedicated resources in place.

3) Quality of the Internal Audit Function: The quality of the internal audit function relates to the amount and quality of the human capital allocated to the internal audit function and to the methodology and tools adopted by the function to carry out its work. According to the model, a "leading" internal audit function must comprise highly trained individuals who have strong knowledge of audit methodology and techniques, along with a thorough understanding of the organization's internal structure and of the risks it faces. "Immature" internal audit functions have a limited or non-existent audit methodology and are unlikely to be able to cover all risks faced by the organization.

4) Spend: This attribute relates to the budget allocated to the internal audit function. At the top end of the model, "leading" internal audit functions concentrate their budget on investment and innovation, providing sufficient funding to cover any market development that would require greater involvement on the part of the internal audit function. At the bottom end of the scale, an "immature" function will have little or no flexibility in the overall internal audit budget, meaning that it will have little room for maneuver in addressing any additional risks the organization might face in the short or medium term.

As indicated by Neelakantan: 'Internal audit teams require a paradigm shift from 'Transaction verification' to 'Process Walkthroughs', a shift from focusing on 'what' to 'how'. Shifting the focus of Internal Audit from an inspection to an advisory mode would, over a period of time, create a collaborative approach across the entire organization for driving improvements, with the

Internal Audit function playing a very crucial enabling and facilitating role. (Neelakantan K., 2011). According to PwC's most recent research on internal audit (2012), some internal audit functions have begun to rethink their fundamental value propositions by shifting from an internal audit model focusing on controls assurance to a risk-centric model where risk and control assurance are based on the effectiveness of risk management processes developed by management. For a relative handful of companies, this shift is already under way, as reflected in Table 2 below. For other companies, the shift will occur over time as corporate risk management frameworks and control processes reach advanced levels of maturity (PwC, 2012).

Table 2: The Shifting Focus of Internal Audit

The 20th-century Internal Audit Model	Today's Typical Internal Audit Model	The Risk-Centric Internal Audit Model of Tomorrow
Controls assurance based on cyclical or routine audit plans	Controls assurance based on risk-based internal audit plan	Assurance on the effectiveness of risk management in addition to controls assurance

Source: PwC, 2012, Internal Audit 2012, A Study Examining the Future of Internal Auditing and the Potential Decline of a Controls-centric Approach.

The model is explained by PwC as follows:

Adding risk management capabilities would inevitably help internal audit align itself more closely with an organization's maturing risk management functions. But doing so would require something not always associated with today's internal audit function: a risk-centric mindset. A risk-centric mindset means that internal auditors adopt an all-inclusive, conceptual approach to audit, risk assessment, and risk management that extends well beyond a narrow focus on controls. With such a mindset, internal auditors would increase their functional value at a time when risk assessment and risk management have become primary stakeholder concerns. As organizations enhance their risk management capabilities, they progress through four stages of risk management maturity. The ability of internal audit to provide value stemming from the delivery of risk assurance depends largely on the maturity of a company's risk management organization and structure—the more mature and developed the structure, the more effective internal audit can be in delivering a risk-centric value proposition.

Stage 1: Internal control: At the first stage of risk management maturity, management is focused on providing assurance that selected key internal controls, typically those in higher-risk areas, are functioning as designed. However, the organization probably has not embraced a formal internal control or risk management framework at this stage, and although it has designed controls, these controls are often not well documented. When an organization is at Stage 1, its management has yet to formally conduct and document an enterprise-wide risk assessment. In fact, its internal audit function may be the only organizational entity to have developed a comprehensive risk assessment. At this stage, the testing and monitoring of internal controls is often viewed primarily as an audit activity as opposed to a management activity. In addition, controls are largely people-dependent, with little or no formal training or communication of control activities taking place.

Stage 2: Sarbanes-Oxley compliance: The Sarbanes-Oxley Act of 2002 requires companies to adopt a common definition of internal control, such as the one promulgated by COSO, and to formally document their internal control activities. The Act also provides the impetus for many companies to formalize their approach to the management, monitoring, and testing of internal controls. Initially, most companies dedicated significant resources to Sarbanes Oxley compliance.

This changed over time as organizations streamlined their compliance processes and improved their abilities to document and monitor internal control efficiency and effectiveness. At Stage 2, the focus of internal controls has broadened beyond that of an audit activity to embrace management ownership of controls. In addition, some corporate management groups have begun to develop formal enterprise-wide risk assessments to strengthen their Sarbanes-Oxley compliance efforts.

Stage 3: Informal risk management: At the third stage of risk management maturity, management develops its own enterprise-wide risk assessment (ERM) and seeks to define ERM for the organization. Management may be setting risk appetites, developing risk management processes, and reporting to the board on its risk management activities. The organization likely has standardized controls, with periodic testing and reporting of results, and it may be employing automated tools to support enterprise-wide reporting of risk and control activities.

Stage 4: Functional enterprise-wide risk management: At the final stage of risk management maturity, management defines and implements formal risk management processes. Management has adopted a formal definition for ERM, such as the COSO enterprise risk management framework, and it has conducted a comprehensive, enterprise-wide risk assessment. Management also sets risk appetites for the organization, manages and monitors responses to risk management issues, and provides assurance to the board as to the effectiveness of the organization's risk management processes. A Stage 4 organization might have a chief risk officer. It might have real-time management and monitoring of risks and control activities. And it might have automated tools in place to support control activities and allow the organization to make rapid changes to those activities in anticipation of emerging risks.

Richard Chambers, the President of the IIA, thinks that internal auditing's focus is also likely to continue evolving. As he mentioned while much of the past decade was spent on auditing financial controls, 2009 and 2010 have seen a resurgence of internal audit coverage in areas of such critical risks as operational, compliance, and fraud. According to a recent IIA survey, internal auditors plan to increase coverage over the following areas (Chambers R., 2010):

- Operational risks – (51%)
- Effectiveness of risk management – (48%)
- Compliance risks – (45%)
- Fraud risks – (44%)
- Cost reduction or containment – (35%)

Chambers mentioned that a number of additional trends are also likely to continue:

- Further emphasis on recruiting non-accounting talent into internal audit functions.
- Continued quests by many internal auditors to enhance their knowledge of the business.
- Increased involvement by internal auditing in promoting and assisting with the establishment of enterprise risk management.
- A surge in the number of external quality assessments by internal audit functions
- Continued discussion/debate on how internal auditing can measure and report on the value it adds.

3.2 Climate

Likewise, the second main component of the model is named as 'Climate'. According to Cambridge Dictionary, climate is (1) the type of situation that exists at a particular time, including the feelings and opinions that are common; (2) the general weather conditions usually found in a particular place. In this context, the 'Climate' component in the model represents the same concept over specific internal audit function being analyzed. Its subcomponents are 'Independence' and 'Governance'.

3.2.1 Independence

For internal auditors, auditor independence refers to an attitude that is free from bias or undue influence. It also embodies the reporting structure of an internal audit function, which includes reporting to the audit committee and the CEO, in order to allow for an appropriate level of organizational freedom and a lack of restriction in their work and access to records. There are often no statutory regulation covering or requiring the independence of internal auditors. While The IIA standards use the word independence to describe internal auditors in certain places, objectivity might be a better word to describe one of the primary characteristics that internal auditors need to exhibit (Protivity, 2009, p.9).

In 2001, the IIA published 'Independence and Objectivity: A Framework for Internal Auditors' (IIA, 2001) as a guide for managing threats to objectivity. The framework identifies seven key threats: these are (I) self-review, where the internal auditor reviews his/her own work; (ii) social pressure, where the internal auditor is exposed to pressure from the auditee, or others on the audit team; (iii) economic interest, resulting, for example, from incentive payments or from auditing the work of someone who has the power to affect the internal auditor's employment or salary; (iv) personal relationship, where the internal auditor is a relative or friend of the auditee; (v) familiarity, resulting from a long term relationship with the auditee including having worked in the unit being audited; (vi) cultural, racial and gender biases arising in multinational organizations when the auditor is biased or lacks an understanding of local culture and customs; and (vii) cognitive biases resulting from preconceived notions or the adoption of a particular psychological perspective when performing the audit. These threats can also occur at the internal audit function level, particularly when the function is involved in both consulting and assurance activities (Stewart J., Subramaniam N., 2009, p.7-8).

According to the IIA website information referring to the Professional Practices Framework and Practice Advisories 1000-1,1100-1,1110-1,1120-1 of IIA:

'Internal auditors are independent when they render impartial and unbiased judgment in the conduct of their engagement. To ensure this independence, best practices suggest the CAE should report directly to the audit committee or its equivalent. For day to day administrative purposes, the CAE should report to the most senior executive (i.e., CEO of the organization). The CAE should have direct communication with the audit committee which reinforces the organizational status of internal auditing, enables full support and unrestricted access to organizational resources, and ensures that there is no impairment to independence. This provides sufficient authority to ensure broad audit coverage, adequate consideration of engagement communications, and appropriate action on recommendations. Independence is further enhanced if the CAE reports to the board through its audit committee on the planning, execution, and results of audit activities. The audit committee is also responsible for the appointment, removal, and fixation of compensation of the CAE. The committee should safeguard the independence by approving the internal audit charter

and mandate periodically. Objectivity is a mental attitude which internal auditors should maintain while performing engagements. The internal auditor should have an impartial, un-biased attitude and avoid conflict of interest situations, as that would prejudice his/her ability to perform the duties objectively. The results of internal audit work should be reviewed before they are released in order to provide a reasonable assurance that the work has been performed objectively. Internal auditors should not assume any operational responsibility. Objectivity can be presumed to be impaired when internal auditors perform an assurance review of any activity for which they had any authority or responsibility within the past year or a period significant enough to influence their judgment or opinion. Internal auditors should not accept gifts or favors from others such as employees, clients or business associates. The internal auditors should adopt a policy that endorses their commitment to abiding by the Code of Ethics, avoiding conflicts of interest, disclosing any activity that could result in a possible conflict of interests. Staff assignment of internal auditors should be rotated periodically whenever it is practicable'.

As indicated in Chrsitopher, Leung and Sarens' study, the importance of internal audit independence has also been highlighted by Krogstad et al (1999) who asserted that internal auditors add value when their reports are objective and insulated from underlying pressure or motivation for a particular outcome or recommendation. Chapman (2001) argues that the primary goal of the individual auditor is objectivity, which involves an unbiased attitude and the avoidance of conflicts of interest which can only be achieved if it is appropriately placed in the organizational structure. Chapman (2001) describes organizational independence as the placement of the internal audit function in the reporting structure so that it is free to determine its scope and perform its work without interference. Bariff (2003) appropriately deals with how the internal audit function can maintain independence from management by noting the following quote from a PricewaterhouseCoopers report (Christopher J., Leung P., Sarens G., 2007):

"Internal audit departments need to ensure organizational posture allows them to operate successfully on strategic issues. This means both the independence and mandate to deal with significant strategic business risks and issues. If inappropriately positioned within the company, internal audit deals with tactical issues and is viewed only at that level. Inappropriate positioning can also raise serious concerns about the overall independence of the function" (PWC, 2002).

Van Peursem (2005) found that internal auditors' close relationship with management can place their independence from management at risk (Stewart J., Subramaniam N., 2009, p.33). Sarens and De Beelde (2006) found that, when internal audit operates primarily in a management support role, there is a lack of perceived objectivity and the relationship with the audit committee is weak (Stewart J., Subramaniam N., 2009, p.33). Hudaib and Haniffa (2009) demonstrated in their paper that 'auditors construct the meanings of independence in appearance and in fact through their social interactions at three levels: micro (personal self-reflexivity through ethical reasoning and reputation of individual auditor); meso (organizational culture through range of commercial activities and image management) and macro (through political, de jure, and socio-economic structure)' (Hudaib M., Haniffa R., 2009). Christopher, Sarrens and Leung (2009) analyzed the independence of the internal audit function through its relationship with management and the audit committee. With respect to the relationship with management, threats identified to independence include: using the internal audit function as a stepping stone to other positions (this threat is also discussed in Christopher, Leung and Saren's study in 2007); having the chief executive officer (CEO) or chief finance officer (CFO) approve the internal audit function's budget and provide input for the internal audit plan; and considering the internal auditor to be a "partner", especially when combined with other indirect threats. With respect to the relationship with the audit committee, significant threats identified include CAEs not reporting functionally to the audit

committee; the audit committee not having sole responsibility for appointing, dismissing and evaluating the CAE; and not having all audit committee members or at least one member qualified in accounting (Christopher J., Sarrens G. and Leung P., 2009). Ahmad and Taylor (2009) concluded that both the role ambiguity and role conflict are significantly negatively related to commitment to independence. The underlying dimensions found to have the greatest impact on commitment to independence are: first, ambiguity in both the exercise of authority by the internal auditor and time pressure faced by the internal auditor; and second, conflict between the internal auditor's personal values and both management's and their profession's expectations and requirements (Ahmad Z., Taylor D., 2009).

3.2.2 Governance

The World Bank defines Governance as follows (Lipchak A., 2002, p.2):

"Good governance is epitomized by predictable, open and enlightened policy-making, a bureaucracy imbued with professional ethos acting in furtherance of the public good, the rule of law, transparent processes, and a strong civil society participating in public affairs. Poor governance (on the other hand) is characterized by arbitrary policy making, unaccountable bureaucracies, unenforced or unjust legal systems, the abuse of executive power, a civil society unengaged in public life, and widespread corruption."

Therefore governance is about rule of law, oversight, accountability and transparency in a structure. A proper governance strategy establishes policies, rules and regulations, implements means to monitor and keep track of what is going on, takes steps to ensure compliance with agreed policies, and provides for corrective action in cases where the rules have been violated or not complied. In this context, the 'Governance' component in the model represents the same concept over specific internal audit function being analyzed.

Governance of the audit function can be grouped into the following categories:

- Establishment and compliance with internal audit objectives, policies, procedures, documentation standards, processes formally approved by the Board of Directors
- Utilization of adequate tools and techniques to be used in the internal audit activity that are formally approved by the Board of Directors
- Establishment and compliance with the plan of organization, statements of job requirements, position descriptions, and professional development plans of the internal audit activity, the continuous improvement activities formally approved by the Board of Directors
- Compliance with applicable laws and regulations, government, industry, or other relevant standard including IIA's standards and guidance (The International Professional Practices Framework)
- Maintenance of ongoing review of activities, periodic assessment and reporting of performance and achievements including both internal and external assessments.

The internal audit charter approved at board level must state the professional standards expected from all staff in the function. Quality of performance in the function and its continuous improvement requires a total commitment, measured and reported at board level through key performance indicators, and feedback from its customers. The purpose of a quality program is to provide reasonable assurance that the internal audit activity's work conforms to the IIA's Standards, the Code of Ethics, the internal audit activity's charter, and other applicable standards (Ridley J, 2009).

The IIA states the following in its website:

'A Quality Assurance and Improvement Program (QAIP) enables an evaluation of the internal audit activity's conformance with the Definition of Internal Auditing and the International Standards for the Professional Practice of Internal Auditing (Standards) and an evaluation of whether internal auditors apply the Code of Ethics. The program also assesses the efficiency and effectiveness of the internal audit activity and identifies opportunities for improvement.

All internal audit activities, regardless of industry, sector, or size of audit staff — even those outsourced or co-sourced — must maintain a QAIP that contains both internal and external assessments. External assessments enhance value, as they enable the internal audit activity to evaluate conformance with the Standards; internal audit and audit committee charters; the organization's risk and control assessment; the effective use of resources; and the use of successful practices. An internal audit activity must obtain an external assessment at least every five years by an independent reviewer or review team to maintain conformance with the Standards.

Internal assessments are ongoing, internal evaluations of the internal audit activity, coupled with periodic self-assessments and/or reviews. This will establish a benchmark of the internal audit activity that can be used to establish metrics. Over time, these metrics will indicate improvement in areas of partial conformance or nonconformance with the Standards and successful practices'.

4. FOUR STAGE MODEL - CALCULATION MECHANICS

As aforementioned, the Four Stage Positioning Model has two components; "competency" and "climate". And the subcomponents of competency are set as 'auditor skill set" and "functional focus/maturity" while the sub-components of "climate" are set as "independence" and "governance".

Each of these individual components needs to be measured (as outlined below) for any internal audit function before they are plotted on a four-stage grid to determine the positioning of this internal audit function. The measurement weights of each subcomponent are considered as equal (meaning that both auditor skill set and functional focus/maturity subcomponent measures have fifty percent weight in representing the competency component; likewise, both independence and governance subcomponent measures have fifty percent weight in representing the climate component).

The Positioning Model includes four stages –'baby/child', 'teen', 'adult', 'elderly'- with each stage designating a different characteristic of that age group for the specific internal audit function being analyzed. To determine which stage an internal audit function falls within, rated scores of 'competency' and 'client' are mapped into the positioning grid with competency component on one axis and client component on the other axis.

Each quadrant in the grid has a name that the characteristic of that stage can be associated with the characteristics of that name. These characteristics are summarized in Table 3 below:

Table 3: Four Stage Model's Quadrants

QUADRANT 1 – BABY/CHILD: BABY: Almost no competency, climate not appropriate at all for effective internal audit function to exist. Just like a baby is dependent on parents to maintain his/her life (e.g. can't eat alone, shouldn't walk alone, etc...), internal audit function is unable to perform its duties effectively and add value. CHILD: Very little competency and relatively improved climate but still unsatisfactory. Just like a child, capabilities to do many things alone increase but parental supervision is important. As a child is still un-protective but self-sufficient in basic life-maintaining matters, internal audit function at this stage is able to perform some of its duties but is still not performing effectively and adding value. This is the least desired zone for the audit function to be.
QUADRANT 2 - TEEN: High competency, climate not appropriate. As a teen's talents and capabilities increase significantly; as teen becomes very energetic but still not considered as a person in legal terms (e.g. can't buy alcohol, cigarettes, can't vote, can't get a driving-license though could be able to drive), the internal audit function has the potential (ability) to perform but due to poor climate conditions, can't perform effectively and add value as it should.
QUADRANT 3 - ADULT: High competency and ideal climate. As a healthy adult living in a first-world modern country do what is expected of him/her and is mature and his/her actions are considered legally legitimate and binding, the internal audit function is able to perform its duties quite effectively. This is the desired zone for the audit function to be (most productive, adding value).
QUADRANT 4 - ELDERLY: Climate is appropriate but competency is low. Just like an elderly, although mature and legal person as in the adult case, because of the reason that talents and capabilities deteriorate as a result of aging, performance in doing things significantly decreases (e.g. can't drive the car well, can't do sports actively, etc...). Despite good climate conditions, the internal audit function at this stage is unable to perform effectively as it should.

The positioning grid can be read as follows: As both competency and climate ratings are low (Quadrant 1 – Baby/Child), the internal audit function is at immature level, not performing effectively and not adding value at all. Internal audit functions that are at their early stages of formation are generally located in this quadrant. If competency is high but climate rating is low (Quadrant 2 – Teen), internal audit is not performing effectively and adding value as it should despite it has the potential means to do so. For instance, if internal audit function is not independent and governed by the appropriate policy and procedures, no matter how qualified and rightly staffed, the desired output will not be maintained. If both competency and climate ratings are high (Quadrant 3 – Adult), then internal audit is functioning effectively and adding value as it should which is the ideal position for the internal audit function to be. At this quadrant the internal audit functions can be seen as a world-class, visionary, in compliance with the best practices. If competency rating is low and climate rating is high (Quadrant 4 – Elderly), then internal audit is not performing effectively and adding value as it should despite it has the appropriate set-up, working infrastructure and environment. As the ideal positioning is in Quadrant 3 (Adult), internal audit functions that are positioned in the other quadrants should implement strategies and take actions to move towards this quadrant. Quadrant 1 (Baby/Child) internal audit function decision makers should take actions that would improve competency and climate conditions (please see the attachment for all factors that are considered under competency and climate headings). Quadrant 2 (Teen) internal audit function decision makers should work on the climate site so that the high competency can pay off. Quadrant 4 (Elderly) internal audit function decision makers should take actions to get younger so that the function can move to the desired positioning by increasing competency.

The model calculation basically works in three steps: the first two steps in the calculation are to rate competency and climate components and to come up with final scores for them. In the third stage, these final scores are mapped into the positioning matrix to determine in which quadrant/stage internal audit function falls into.

Two different internal audit departments will be positioned as two cases by using the Model.

Case 1: XX Internal Audit Department

Case 2: YY Internal Audit Department

As indicated, the three step approach will work as follows:

Step 1: Measure and calculate component 1. 'Competency' is defined as component 1.

Step 2: Measure and calculate component 2. 'Climate' is defined as component 2.

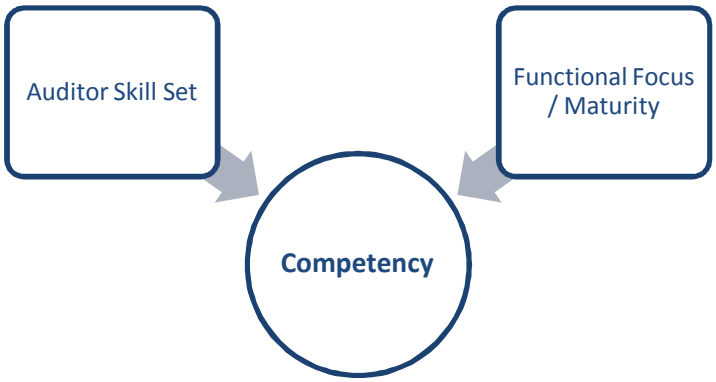
Step 3: Map component 1 and 2 in the Four Stage Model Grid to determine the positioning of the related internal audit department.

The details are explained with examples below:

Step 1: Measure and calculate component 1 in accordance with list 1 in the appendix section (measurement required in a scale of 1 to 10)

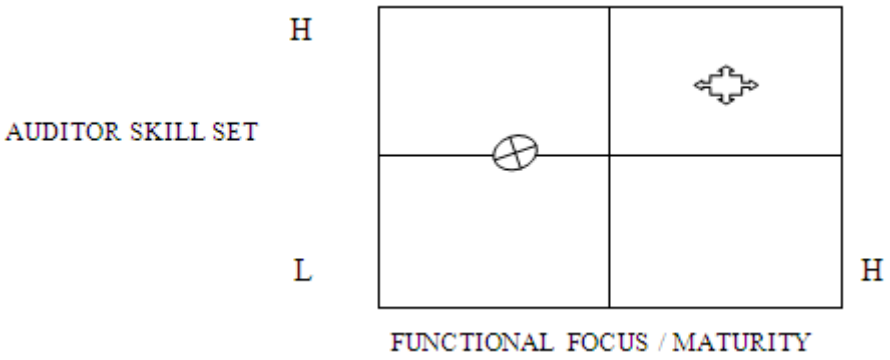
Component 1 -represents 50% share in the Model- Competency Map (A)

Figure 6: Subcomponents of the Competency Component



Each subcomponent is measured by conducting a survey to the audience (e.g. the board of directors, chief audit executive, top management) for all the assertions indicated in list 1 in the appendix section with a measurement scale of one to ten. The overall average of all the responses will be the grading to be mapped on the following grid:

Figure 7: Internal Audit Competency Status



Case 1. Grading Assumptions - Independence: 6; Governance: 4

Climate component grading of Case 1: 6 * (0,50) + 4 * (0,50) = 5 (final grading)

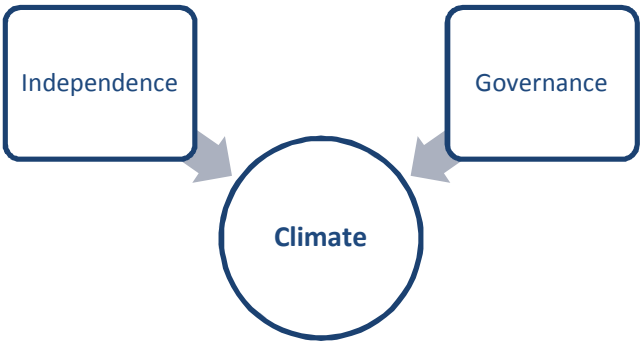
Case 2. Grading Assumptions - Independence: 7; Governance: 7

Climate component grading of Case 2: 7 * (0,50) + 7 * (0,50) = 7 (final grading)

Step 2: Measure and calculate component 2 in accordance with list 2 in the appendix section (measurement required in a scale of 1 to 10)

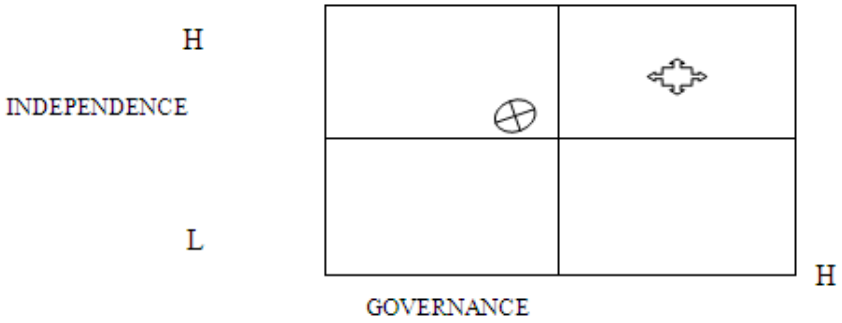
Component 2 -represents 50% share in the Model- Climate Map (B)

Figure 8: Subcomponents of the Climate Component



Each subcomponent is measured by conducting a survey to the audience (e.g. the board of directors, chief audit executive, top management) for all the assertions indicated in list 2 in the appendix section with a measurement scale of one to ten. The overall average of all the responses will be the final grading to be mapped on the following grid:

Figure 9: Internal Audit Climate Status



Case 1. Grading Assumptions - Independence: 6; Governance: 4

Climate component grading of Case 1: 6 * (0,50) + 4 * (0,50) = 5 (final grading)

Case 2. Grading Assumptions - Independence: 7; Governance: 7

Climate component grading of Case 2: 7 * (0,50) + 7 * (0,50) = 7 (final grading)

Step 3: Map component 1 and 2 in Four Stage Model

Internal Audit Positioning / Four Stage Model

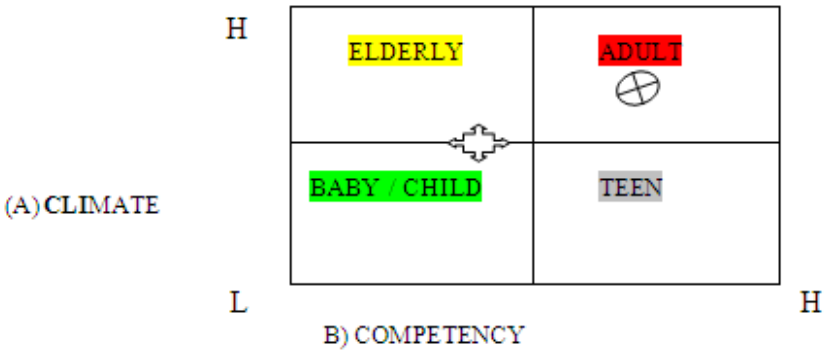
Combined Effect – (A) X (B)

The last step in order to position the related internal audit department on a platform, final grading of each component is mapped on the following grid:

Case 1. Competency grading: 4; Climate grading: 5

Case 2. Competency grading: 7; Climate grading: 7

Figure 10: Mapping of the Internal Audit Function in the Four Stage Model



As can be seen in the above grid, case 1 internal audit function is positioned in quadrant 1 and can be considered a small child while case 2 internal audit department is positioned in the ideal quadrant 3 and can be considered an adult.

5. CONCLUSIONS

With respect to the evolvement of the internal audit in Turkey in comparison with the best practices outlined by the IIA, the application of the Four Stage Model can be very useful for the decision makers to direct the allocation of resources to the internal audit function. It will also assist the Chief Audit Executives to make more effective audit planning, budgeting, staffing, training, and execution; thus, it will be a means for more effective utilization of the resources already available and those that will be available. Everything in the modern internal audit is about 'adding value'. The Internal Auditing Four Stage Modeling will be a guideline and indispensable effective tool for this purpose.

As mentioned within this research, the evaluation of auditor skill sets, functional focus & maturity, independence and governance which are the main aggregate components to assess the level of internal audit function need to be made objectively and measured accurately. The scoring of individual factors identified for each component need to be based on scientific research as much as possible to make the best use out of the model. These are the critical success factors for the use of this model.

The increasing complexity of business transactions, more dynamic regulatory environment, efforts to reduce unrecorded economy and significant advances in information technology are developments that have resulted in opportunities and challenges for internal audit. In the next periods the scope of internal auditing will be extended and current regulations will be restructured in accordance with international standards. In this line, the expectations of stakeholders towards the internal audit function are increasing. Although the internal audit function plays a vital role in the financial and real sectors, particularly in terms of corporate governance, risk management, fraud prevention and detection and cost containment processes, the internal audit practice and framework in Turkey should be improved.

It is crucial that the function of internal audit as it is practiced by international standards and the added value that it brings to the organizations needs to be marketed to wider audiences in Turkish business community. This study aims to contribute to increase the awareness level; thus, motivate decision makers of Turkish organizations to interrogate and challenge what they should be expecting from internal audit function.

REFERENCES

Ahmad Z., Taylor D. (2009). Commitment to Independence by Internal Auditors: the Effects of Role Ambiguity and Role Conflict, Managerial Auditing Journal, Vol.24, Iss: 9, pp.899-925

Berry R. (2012). 3 Keys to Being a Top Performing Auditor, That Audit Guy web-site article, available online at http://www.thatauditguy.com/author/robert-berry/

Chambers R. (2010). Looking Ahead to 2011: What Does It Hold for Internal Auditing, the IIA website article, posted December 15, 2010, available on line at: http://www.theiia.org/blogs/chambers/index.cfm/post/Looking%20Ahead%20to%202011:%20What%20Does%20It%20Hold%20for%20Internal%20Auditing

Christopher J., Sarrens G. and Leung P. (2009). A Critical Analysis of the Independence of the Internal Audit Function: Evidence from Australia', Accounting, Auditing & Accountability Journal, Vol: 22, pp.200-220

Christopher J., Sarrens G. and Leung P. (2007). An Exploratory Study on Internal Audit Independence in Australia', AFAANZ Conference, July 1-3, 2007

Deloitte (2009). The Changing Role of Internal Audit, available on line at: http://www.deloitte.com/view/en_BE/be/services/aers/internalaudit/efeb39896dea7210VgnVCM100000ba42f00aRCRD.htm

Ensel E., O'Neal E., Stelzer M., Testa D. (2012). KMEF Knowledge Functions and Competencies, Institute for Knowledge and Innovation Education Forum Annual Summit, the George Washington University

Ernst & Young (2009). Metamorphosis (Part 2): Assessing the Maturity of Your Internal Audit Function, available on line at: http://www.ey.com/Publication/vwLUAssets/Metamorphisis_II:_Assessing_the_maturity_of_your_internal_audit_function/$FILE/Metamorphosis_Assess_Maturity.pdf

Hudaib M., Haniffa R. (2009). Exploring Auditor Independence: An Interpretive Approach, Accounting, Auditing & Accountability Journal, Vol.22, Iss: 2, pp.221-246

Johnson S. (2012). Do Your Internal Auditors Have the Right Skills? CFO.com article, available online at http://www3.cfo.com/article/2012/4/auditing_internal-audit-skills

IIA Australia (2010). Internal Auditor Competency Framework, Australia, available online at: http://www.iia.org.au/Libraries/Learning_Development/Internal_Audit_Competency_Framework.sflb.ashx

IIA Research Foundation (2010). Core Competencies for Today's Internal Auditor, Altamonte Springs, FL

Lipchak A. (2002). Evidence-based Governance in the Electronic Age: A Summary of Key policy Issues, The International Records Management Trust, UK

Neelakantan K. (2011). Internal Auditing – Shifting from 'Inspection' Mode to 'Advisory' Mode, Morison Menon website article, available on line at: http://www.morisonmenon.com/internal-auditing-shifting-from-inspection-mode-to-advisory-mode.php

Nissley E. (2011). Core competencies for Today's Internal Auditor, The RMC Advisors (Risk, Management, Control) web site article, available online at: http://www.thermcadvisors.com/2011/01/core-competencies-for-todays-internal-auditor.html

Protivity (2009). Guide to Internal Audit / Frequently Asked Questions About Developing and Monitoring an Effective Internal Audit Function, 2nd. Edition, available on line at: http://www.intellityconsulting.com/recursos/recurso/GuideInternal_Audit-FAQs-2n_Edition.pdf

PwC (2012). Internal Audit 2012, A Study Examining the Future of Internal Auditing and the Potential Decline of a Controls-centric Approach, available on line at: http://www.pwc.com/sg/en/advisory/assets/publication-internal-audit-2012.pdf

Ridley J. (2009). Starting a Successful Internal Audit Function to Meet Present and Future Demands, QFINANCE website article, available on line at: http://www.qfinance.com/auditing-best-practice/starting-a-successful-internal-audit-function-to-meet-present-and-future-demands?full

Stewart J., Subramaniam N. (2009). Internal Audit Independence and Objectivity: A Review of Current Literature and Opportunities for Future Research, Griffith University, Griffith Business School, Discussion Papers Accounting.

Tapestry Networks (2011). Internal Audit's Evolving Role: A Proactive Catalyst of Business Improvement. Insights for North American Audit Committee Members, Ernst & Young, available online at http://www.tapestrynetworks.com/upload/Tapestry_EY_ACLN_InSights_Apr11.pdf.

The Institute of Internal Auditing Research Foundation (2009).Internal Audit Capability Model (IA-CM) for the Public Sector available online at https://na.theiia.org/iiarf/Public%20Documents/Internal%20Audit%20Capability%20Model%20IA-CM%20for%20the%20Public%20Sector%20Overview.pdf.

Wikipedia, Competence (Human resources) Article, available on line at: http://en.wikipedia.org/wiki/Competence_(human_resources).

Wery P. (2012). Enhancing the Internal Audit Function through the Internal Audit Maturity Model, PwC web site article posted on October 2012, available on line at: http://www.pwc.lu/en/press-articles/2012/enhancing-the-internal-audit-function.jhtml.

http://www.theiia.org/ Website of the Institute of Internal Auditors, the Professional Practices Framework and Practice Advisories 1000-1,1100-1,1110-1,1120-1, available on line at: https://na.theiia.org/standards-guidance/Pages/Standards-and-Guidance-IPPF.aspx.

http://www.theiia.org/ Website of the Institute of Internal Auditors, Quality Assurance, available on line at: https://na.theiia.org/services/quality/Pages/Quality-Assurance.aspx.

https://global.theiia.org/ Website of the Institute of Internal Auditors, Components of Common Body of Knowledge - CBOK, available on line at: https://global.theiia.org/iiarf/pages/common-body-of-knowledge-cbok.aspx.

Appendix

List 1: Competency factors to be considered in assessment under each heading

Auditor Skill Set

An internal audit department is considered as having good auditor skill set if the following conditions are met:

- Auditors should have working knowledge of internal audit techniques and methodologies (know-how)
- There should be practical knowledge in the department on the use of the CAAT (Computer Assisted Auditing Techniques) tools
- Auditors should possess good MS Office (or its equivalent) skills (e.g. Excel, Visio, Word, Power Point, Access) and that they are IT literate
- Auditors should have adequate business exposure to understand business dynamics, processes, organizational dynamics and key risks
- Auditors should be well trained and informed about corporate governance, internal control and risk management concepts
- Auditors should have extensive ERP exposure
- There should be practical knowledge in the department on using IT audit skills (e.g. employs IT auditor)
- There should be practical knowledge in the department on fraud related investigations and special assignments
- Auditors should possess research and investigation, data collection/analysis, basic statistics, problem solving technical skills
- Auditors should possess the following soft skills: effective communication, job management, team play
- Auditors should have an analytical mind and an investigative spirit
- Auditors should have high ethical standing
- Auditors should possess effective project management skills
- The auditor mix in the department should allow multidisciplinary knowledge transfer among auditors (e.g. auditors with financial and managerial accounting background, industrial engineer background, law background, experience in security, administration, production, quality, occupational health & safety, regulatory, ethics, and other related areas...)
- Auditors should have effective report writing skills
- Auditors should be hard working, result oriented and systematic
- Auditors should hold credible occupational certifications such as CIA (Certified Internal Auditor, the most desired one), CCSA, CGAP, CFSA, CFE, CRMA, CMA, CFA, CPA
- There should be good knowledge about internal audit standards and guidance issued by the IIA (Institute of Internal Auditors)
- There should be continuous training programs in effect

Functional Focus / Maturity

The left side of the box is at one extreme edge of the maturity spectrum (not mature) and the right side of the box is the other end of the spectrum (mature)

Factors to be considered in the Functional Focus / Maturity Component

Detective	Preventive (risk focused)
Policeman	Business Enhancer / Consultant
Reactive	Proactive
Transaction focus	Process focus
Stand Alone	Participate with Management
Financial Risk Management	Enterprise Risk Management
Financial Controls	Internal Controls
Financial Audit	Risk-Based Operational Audit
Investigating Fraud	Internal Control Systems
Audit planning based on function/ department/location & time since last audit	Risk-Based Process Oriented Audit Planning
Compliance Audits	Operational Audits, Performance Audits, IT Audits
Compliance focused tight controls	Value Adding/flexible controls (cost/benefit)

List 2: Climate factors to be considered in assessment under each heading

Independence

Independence is at very good levels if all the following conditions are met:

- Auditors should be free to write audit findings as they see appropriate
- Auditors should not be involved with operational duties (conflict of interest)
- Auditors should not be given the responsibility to set the risk appetite of the management
- Chief Audit Executive (CAE) should be able to report to the Board of Directors and the Audit Committee without any restriction
- Functionally, CAE should not be reporting to line management (e.g. CFO) including CEO
- Auditors should not be dictated as to what to audit and how
- Auditors should have unlimited access to any information for their work purposes
- CAE's compensation (and performance evaluation) should only be decided by his/her functional reporting authority (e.g. Board of Directors, President of the Board of Directors)

Governance

Governance is at high level if all the following conditions are met:

- The audit activities should be governed by an audit charter approved by the Board of Directors / Audit Committee
- Formal and approved internal audit objectives, policies, procedures, documentation standards and processes should direct the auditors' efforts
- Formal and up-to-date job descriptions and development plans should exist
- Regulatory bodies and / IIA's International Professional Practice Framework heavily regulates and dictates the work of internal auditors and that there is satisfactory compliance with these
- Approved tools and techniques should be used in the internal audit activity
- Audit report recommendations should be seriously acted upon and followed up by management with required/needed attention
- Audit function's effectiveness and its alignment with the Internal Auditing Standards and Guidance issued by the Institute of Internal auditors should be assessed by a credited 3rd party

Ongoing review of activities, periodic assessment and reporting of performance should include internal assessments as well as external.