Lights, camera, action...
scripting internal audit for a changed world

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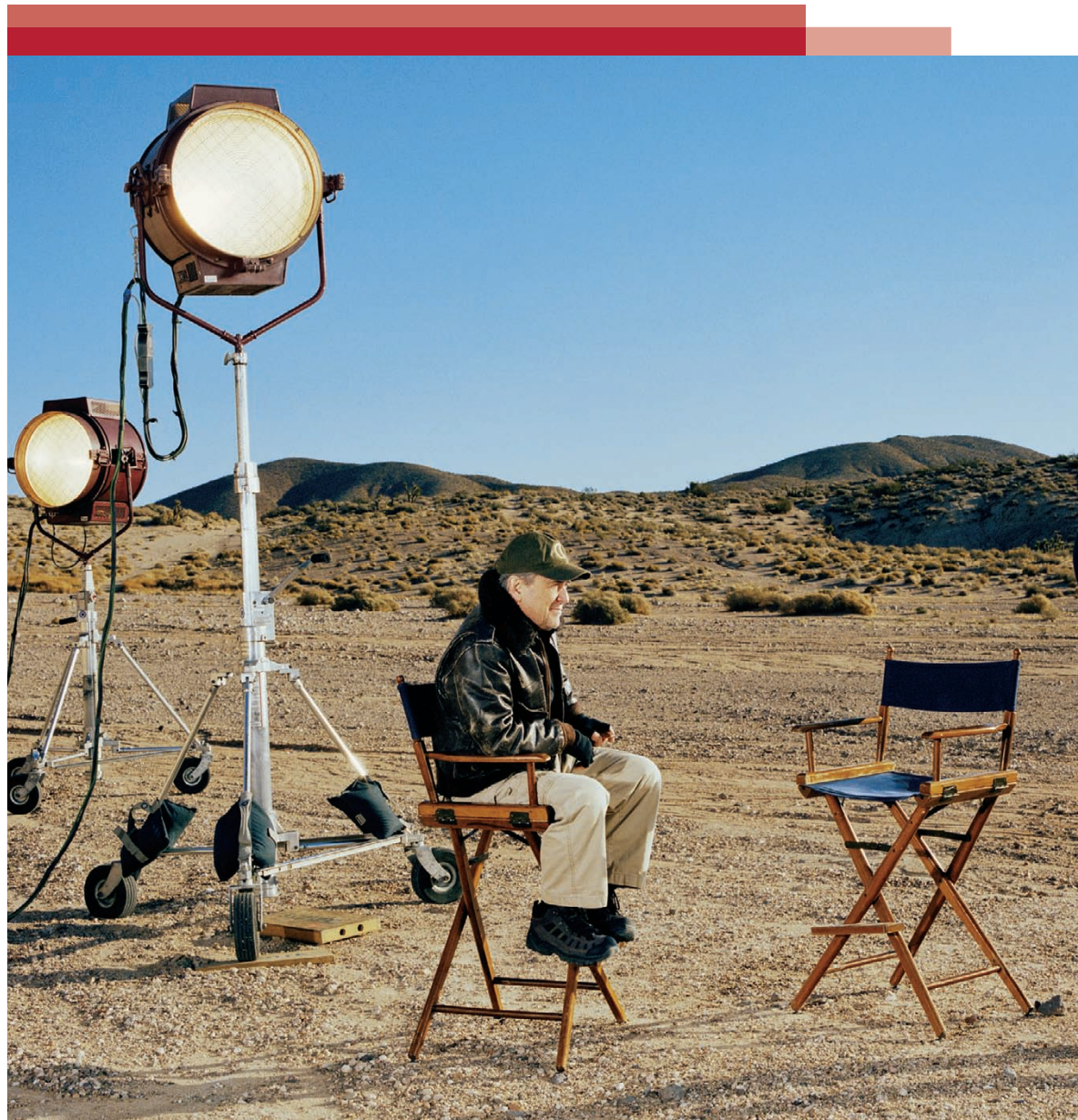
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Growth and risk are in the spotlight

After several years of extreme financial uncertainty, there's a surprising level of confidence among the chief executive officers (CEOs) who responded to our annual Global CEO Survey. In the 2010 survey, business leaders were focused on risk management, crisis prevention, and cost efficiencies. Correspondingly, our 2010 State of the Internal Audit Profession Study revealed that internal auditors were intent on meeting the changing needs and expectations of their stakeholders, including the CEO. The focus then was on new approaches to risk assessment, integration with other risk and compliance functions, and strategies for enhancing internal efficiency—all to address the overriding challenge of doing more with less.

Confidence returns

In 2011, however, the CEO survey results reflect confidence, innovation, and the need to bridge skills gaps to meet emerging growth opportunities. The prospect of robust growth in emerging markets is a primary reason why 84% of CEOs who participated in our 2011, 14th annual Global CEO Survey say they've changed their company strategy. Of those, a third described these changes as "fundamental."

However, many felt growth prospects would be uneven, thus they are reevaluating strategies in areas such as talent and innovation as they reconsider the upside of working more closely with partners and governments. Because these varying prospects require different approaches, companies continue to invest in technology to enhance internal efficiency and employ emerging applications such as social media, mobile devices, and cloud computing.

In addition to these changes, the balance of corporate power continues to shift. Shareholders and regulators demand transparency, accountability, and more input on issues once reserved for management and the board of directors. New rules, further disclosures, and strict enforcement are causing dramatic changes for businesses around the globe; including banking and capital markets, healthcare, private equity, and nearly every other industry.

Growth reimagined

CEOs who anticipate how business is changing and creatively search for value in new markets with new customers and partners expect to find great opportunities. As their CEOs step onto a larger stage, internal auditors should be taking a similar approach by preparing for a best supporting actor role. And as their companies focus outward, internal auditors would be wise to expand their reach to encompass a more diverse set of risks and engage stakeholders on the need for support in nontraditional areas.

Internal audit leaders can help their audit committees and management understand an extraordinarily dynamic and complex risk environment and make it easier to adapt to a rapidly changing world. Those who succeed in this endeavor will add tremendous value; those who do not seize this opportunity risk losing relevance within their organizations.

Internal audit responds

Our 2011 State of the Internal Audit Profession Study examines how internal audit is responding to this changing risk environment. Our results and interviews with leading internal audit professionals reveal three distinct areas of concern: strategic growth, emerging technologies, and increasing regulation. However, the survey data also shows a lack of confidence in internal audit's ability to address these topics.

As noted above, we interviewed chief audit executives to learn how they are responding to today's business challenges. We consistently heard that the skills necessary for success are effective communication, an ability to build strong relationships with company leadership and the audit committee chair, and the capacity to engage partners, both inside and outside the company. We also found that leading internal audit professionals are preparing to play a significant role in a changed world.

Scripting internal audit for a changed world

As internal audit organizations strive to transition from financial controls oversight to advising on a wide range of strategic, business, and compliance risks, it's imperative that they establish credibility with company leaders by demonstrating their skills and capabilities in these areas. If your internal audit function is not involved in significant company initiatives, you should ask why. Is it because your team lacks the required knowledge or skills to contribute? Or, is it because your internal audit function hasn't earned a seat at the table?

As we see it, a need to grow the business in emerging markets, to stay competitive by adopting innovative technologies, and to respond to a rapidly changing regulatory environment underpin the critical risks facing today's businesses. If you understand those risk areas, develop and demonstrate capabilities to address them, and then ask for a seat at the table, you'll be invited as long as you deliver value.

What follows is an analysis of how our 2011 State of the Internal Audit Profession Study participants are preparing for a changed world and how their actions compare with what leading internal audit professionals are doing to meet those same challenges.

New growth, new risks

Only half the world is growing at a robust rate. Although the International Monetary Fund (IMF) forecasts global growth at 4.2% for 2011, developed countries—which make up 52% of the world economy—are growing at half that pace. In contrast, emerging markets are booming, with Indonesia, India, and China all forecast to grow faster than 6%.

Ninety-two percent of Western European CEOs expect growth in their Asian operations, while only 48% expect growth in their European operations. Similarly, CEOs from Asia-Pacific and Latin America are more likely to expect growth in their own regions than elsewhere. In both cases, this likely represents a break from the recent past, when increasing consumption in developed markets was a primary driver of growth.[1]

And yet, our 2011 State of the Internal Audit Profession Study shows that most internal audit organizations are only marginally involved in risks associated with growth in emerging markets, cross-border acquisitions, and new

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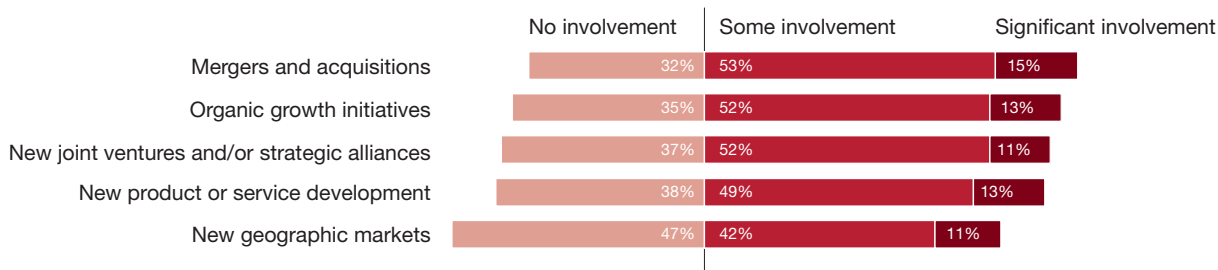1 14th annual Global CEO Survey, PwC, January 2011

joint ventures or strategic alliances. When asked whether internal audit effort would increase or decrease over the next three years, close to 80% indicated an increased focus on strategic initiatives and programs while only 57% said they planned an increase in coverage at international locations (Figure 2). Further, only 36% indicated a need to expand their multinational experience (Figure 7).

When asked more specifically about internal audit's involvement in the leading growth opportunities identified in our CEO surveys, growth in newer geographic markets—an area with arguably the greatest risk—was the lowest priority among survey participants. However, the most striking

aspect of the results for this question was the relative lack of depth with respect to internal audit's involvement in any of these growth initiatives, with only 11% to 15% indicating "significant involvement" (Figure 1).

As companies place renewed emphasis on growth from an expanding range of sources, it will be incumbent upon internal audit to focus on the risks associated with these strategic initiatives. Our survey results indicate that a minority of internal audit functions are diverting significant attention to these areas. Our interviews with CAEs confirmed that leading internal audit functions have strategic growth initiatives near the top of their risk and audit agendas.

Figure 1. Rate your Internal Audit function's level of involvement in the following areas.[1]

	No involvement	Some involvement	Significant involvement
Mergers and acquisitions	32%	53%	15%
Organic growth initiatives	35%	52%	13%
New joint ventures and/or strategic alliances	37%	52%	11%
New product or service development	38%	49%	13%
New geographic markets	47%	42%	11%

[1] If applicable

Figure 2. Indicate whether the level of focus in the audit plan for the following activities will increase or decrease in the next three years.

	New information technology systems or process/control environments	Process improvement/ operational efficiency/cost reductions	Enterprise risk management programs	Strategic initiatives and programs	Operational controls, ethics and compliance	Existing information technology controls	Regulatory compliance programs	International locations	Investigations	SOX/Financial reporting
Increase	90%	82%	79%	78%	73%	63%	60%	57%	47%	38%
Decrease	10%	18%	21%	22%	27%	37%	40%	43%	53%	62%

Emerging markets

The prospect of new growth in emerging markets is enticing to businesses in a wide range of industries. Our discussions with leading internal auditors confirmed a strategy to direct disproportionately more audit attention to these higher risk locations than their size or materiality would otherwise warrant. Primary areas of focus within these high-risk locations included order to cash, treasury, procurement, capital expenditures, and regulatory compliance.

To help their companies address the risks associated with emerging market expansion, leading internal audit organizations are taking actions such as:

- Facilitating emerging risk discussions with the executive team and the audit committee. Making growth in emerging markets and the associated risks a prominent audit committee agenda item. Considering political stability, cultural differences, regulatory environment, and

availability of competent resources in performing country-specific risk assessments.

- Getting involved early in the development stage to establish a strong system of internal controls. Assessing whether policies and procedures at the local level appropriately balance the objectives of: consistency with corporate standards and values; local laws, regulations, and accounting standards; and practicality and sustainability in the local culture.

- Using detailed data analytics to remotely plan location audits thereby sharpening audit focus, shortening their duration and making it possible for more audits to be performed.

- Working with management to develop targets and recommended actions to achieve acceptable control environments for operations located in emerging markets. Determining

whether management, the audit committee, and internal audit have a common understanding of the time line to achieve mature country control standards.

- Consolidating issues from audits in emerging markets in regular executive reports to ensure common themes are understood, communicated, and addressed across geographic boundaries.

- Becoming knowledgeable about the US Foreign Corrupt Practices Act (FCPA), the UK's Bribery Act and other relevant anticorruption standards. Making that knowledge relevant to management and the audit committee by showing how it can affect planned growth strategies in emerging markets.

- Building local or regional satellite functions and partnering with other risk and compliance functions to develop local knowledge of business practices, regulatory standards, and culture—all of which is critical to successfully navigating the risk environment. Leading internal audit organizations establish international co-sourcing arrangements to expand geographic reach and capabilities to better identify and audit risks.

- Playing a primary role in monitoring risks through regular and ongoing site visits; offsite reviews of significant financial and operating metrics; participating in delivery of training programs; and interacting regularly with company leadership at the corporate, regional, and local levels.

Merger and acquisition activity

Inorganic growth through mergers and acquisitions can accelerate growth, but it also involves a wide array of risks. Internal audit can help management identify and assess these risks. Moreover, internal audit can play an important role after the deal is consummated by helping management realize synergies and reduce costs through, for example, a controls rationalization project. Leading internal audit functions become involved in the merger and acquisition (M&A) process from the pre-acquisition due diligence phase to the post-deal integration by taking the following actions:

- Conducting pre-acquisition assessments of the governance, risk, and control environment; primary business process controls; information technology (IT) systems; compliance programs; and risk and control culture at the target company.

- Assessing opportunities and developing plans for integration of internal audit, Sarbanes Oxley compliance, risk management, and other compliance functions. Understanding differences in audit and risk management strategies, approaches, and culture and using best practices from each company.

- Becoming an advisor to post-deal integration teams with respect to process and control design; IT system integration; data migration, quality, and security; validation and tracking of benefits and cost savings; and project management assurance.

- Conducting audits within a short time after closing the deal for routine acquisitions. For large acquisitions in new geographies, internal audit should become part of the integration team to make sure control standards are met from day one and prior control weaknesses are remediated.

Innovation and new product development

As companies see hints of economic recovery, they are striving to be first to get back in the game and asking how they will do it.

Largely, the answer will be innovation, and new product development, while achieving efficiencies needed to cut and sustain costs, improve performance, and compete in an increasingly automated business environment.
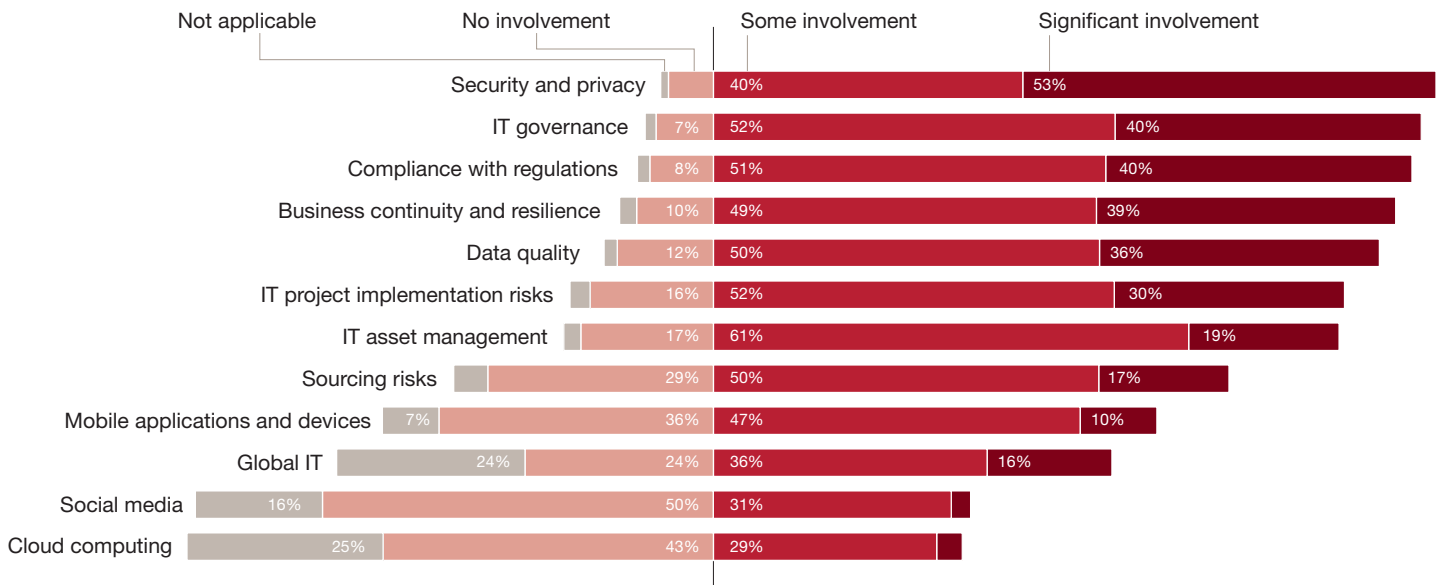
Traditionally, internal audit functions have been reluctant to venture into strategic initiatives such as these, believing strategic risks should remain in the domain of senior management. After all, what qualifies internal audit to question company strategy? What do they know about product development?

In our view, and in the opinion of other leading CAEs, internal audit can play a substantial role in supporting strategic initiatives, without venturing into strategy development or second guessing strategic decisions. Virtually all strategic initiatives have projects, processes, controls, and metrics to ensure their successful execution.

There is an important role for internal audit in evaluating execution risks and providing assurance to management and the audit committee that such risks are appropriately communicated and managed. For example, internal audit is playing a role by:

- Evaluating project management structure, governance procedures, project risk assessments and issue resolution processes. Assessing processes for tracking and reporting key project data and performing tests for data integrity.

- Participating in the steering committees of significant strategic initiatives to provide an objective and transparent view of project risks, status reporting, and benefits realization.

- Auditing and monitoring the business innovation execution risks by auditing the research and development road map, engineering processes, finance authorizations, and new product development gating processes

- Developing an approach for auditing third-party product development, where it has become a new and significant component of the organization's innovation strategy

- Becoming knowledgeable about emerging business models and by communicating the associated risks to management and the audit committee

- Recruiting from the business or using external resources to effectively execute roles similar to those above if relevant knowledge and skills are lacking

Figure 3: To what extent are you devoting audit effort to the following areas of technology risks?

	Not applicable	No involvement	Some involvement	Significant involvement
Security and privacy			40%	53%
IT governance		7%	52%	40%
Compliance with regulations		8%	51%	40%
Business continuity and resilience		10%	49%	39%
Data quality		12%	50%	36%
IT project implementation risks		16%	52%	30%
IT asset management		17%	61%	19%
Sourcing risks		29%	50%	17%
Mobile applications and devices	7%	36%	47%	10%
Global IT	24%	24%	36%	16%
Social media	16%	50%	31%	
Cloud computing	25%	43%	29%	

Ups and downs of emerging technologies

Close to 70% of CEOs who participated in our 14th annual Global CEO Survey are investing in IT to reduce costs and become more efficient, while 54% are funneling money toward growth initiatives, including emerging technologies in mobile devices, social media, and data analytics. In the survey, CEOs told us they are exploring possibilities for technology and are considering the risks and benefits of cloud computing.

Additionally, many companies postponed or delayed enterprise resource planning (ERP) system implementations and upgrades as a result of the financial crisis. Those plans are now moving ahead, and management is looking not only for help in ensuring that these systems are secure and well-controlled but also that they are getting the most from their ERP investment.

And as emerging media and communications technologies grow more popular, brand protection, security, and privacy risks are on the rise. However, less than half of the respondents to our State of the Internal Audit Profession Study indicated they will be involved in auditing risks associated with cloud computing or social media, with fewer than 5% indicating significant involvement (Figure 3). Although more than half expect to be involved in addressing risks associated with mobile applications, only 10% are planning significant involvement.

The vast majority of our survey respondents indicated that they will concentrate on technology risks in the next three years, with 90% saying they will increase focus on new system implementations and 63% increasing their efforts on existing systems. At the same time, survey respondents said specialized technology expertise is one of the areas where new skills and capabilities are most needed (66%).

When asked about specific areas of technology risk that will be receiving audit attention, our survey participants almost universally planned involvement in traditional areas such as security, data integrity, system implementations, and business continuity. Our survey results and our

discussions with CAEs also indicate that internal audit is raising its focus from application level risks to functional risks, such as IT governance and asset management. And while involvement in new system implementation projects is nothing new, we see internal audit's roles in these projects expanding to project assurance and benefits realization.

Despite the fact that our survey results show little to moderate interest in emerging technologies such as cloud computing, social media, and the use of mobile devices, our discussions with CAEs indicates that leading internal audit functions are actively engaging with internal and external subject matter experts to address the related risks.

The CAEs we talked to about technology were unanimous in saying the risk lies in the speed in which advances are made. Who could have predicted just three years ago the predominance of social media in today's business world or that an entire IT department could be outsourced to the cloud?

Leading CAEs recognize that technology evolves faster than other risk areas and will require a fresh perspective on how to create value for company stakeholders. They also predict emerging technology will present challenges in recruiting talent, which may create the need to seek partnership arrangements with other functions in the company as well as service providers.

Within the realm of technology, the greatest areas of concern for leading internal audit professionals include company plans for new or upgrades to existing ERP systems, and the pervasive use of social media, e-mobility devices, and cloud computing.

ERP upgrades and implementations

Although many internal audit functions have had some level of involvement in IT system implementation projects, the breadth and depth of that involvement varies widely. Leading functions are being integrated into the implementation project teams and are viewed as key advisors in managing a broad range of technical, business process, and project risks. A comprehensive approach to managing the risks associated with these projects involves a focus on three key outcomes.

Controls outcomes: Is there confidence that the internal control environment can be enhanced to more effectively and efficiently meet operational, regulatory, and financial reporting requirements?

Project outcomes: Is there confidence that the projects will be completed on time, on budget, and to the required quality?

Business outcomes: Is there confidence that the business benefits will be appropriately identified and realized?

Leading internal audit functions are playing important roles across each of these project objectives and delivering value throughout a variety of pre- and post-implementation activities:

- Evaluation of manual and automated controls designs in new business processes

- Assessment of modifications to business processes, including development of documentation and optimization of the control environment

- Evaluation and monitoring of project risk and project management protocols

- Evaluation of the benefits framework and measurement process

- Evaluation of system security and segregation of duty models

- Assessment of data migration strategies and testing of data quality and integrity

"When you think about the differences between technology changes and accounting standards changes, you're talking night and day. Think about cloud computing; it's changing at the speed of light compared to changes to accounting standards. Think about how quickly a virus can infect your systems. These are things you have to deal with right now."

A leading CAE

Social media, e-mobility, and cloud computing

The emergence of social media, e-mobility, and cloud computing represents significant opportunities for companies to interact with employees and customers in ways never before considered. These opportunities also represent heightened risks associated with reputation and brand damage, data leakage, and security. However, if these risks are well managed, opportunities for reduced costs and access to new revenue streams can be great.

Social media and e-mobility

Social media and networking technology refers to a range of software programs that are often web-based and allow users to interact and share data with other users. These interactions occur through the forming of communities and the empowerment of individuals within these communities to engage with one another. This computer-mediated communication has become popular with social sites such as Facebook, Twitter, and MySpace, as well as media sites such as Flickr and YouTube, and commercial sites such as Amazon.com and eBay.

For businesses, social networking and e-mobility can be a transformational phenomenon, introducing new ways of engaging consumers and new ways to empower and engage employees and stakeholders. Business uses of social networking technologies include marketing, idea management, and recruitment.

There is, no doubt, a significant potential for growth through the use of social networking to connect with customers and employees. This opportunity should not be underestimated. By connecting with customers and clients through this new channel, organizations are able to build brand loyalty and easily share ideas. However, with this opportunity comes increased risk:

- **Damage to brand:** Social networking provides customers with an outlet to share comments about a company, its products and services. This can be valuable if constructive; however, if done maliciously, this can taint a company's brand image. For example, employees staging a joke about food preparation at a national pizza chain posted a video on YouTube. Within days the video had been viewed more than a million times, and it showed up in the top ten Google search returns.

- **Data loss:** With employees having a direct connection to so many people, there is an increased risk that proprietary information could be accidentally or intentionally leaked to the public. These multiple connections can also lead to customer data loss due to hacking.

- **Distribution of malware:** Due to increased connectivity with social networking, even a minor system hack can spread quickly. For example, services such as TinyURL, Bit.ly, and Cligs have become popular as they allow URLs to be displayed in a more succinct form by Twitter users. There have been hacking incidents in which these shortened URLs were changed to a single URL, presenting a risk that users could be redirected to malicious websites.

According to PwC's 2011 Global State of Information Security Survey®, few companies are adequately prepared to counter these types of risks. Most companies (60%) have yet to implement security technologies supporting Web 2.0 exchanges, such as social networks, blogs, or wikis. And even more (77%) have not established security policies that address the use of social networks or Web 2.0 technologies—a critical strategy with minimal costs.

Internal audit leaders can help by:

- Assisting with the development of policies that address the specific needs of the company, balancing risks with the opportunities represented by technology

- Ensuring that security policies for mobile devices are centrally managed and enforced (password length and complexity) and that the devices can be remotely locked and "wiped clean" if lost or stolen

- Performing a risk assessment to determine whether the expenditure for mobile antivirus software is warranted

- Monitoring use and compliance with corporate IT resource policies

- Assessing controls over e-mobility cost management to help ensure the company is receiving appropriate discounts and has structured billing plans to minimize costs

Cloud computing

A report completed by PwC found that cloud computing is poised to be the most transformative, technology-driven development in business since the emergence of the Internet. Leading companies are beginning to recognize and capitalize on the cloud's lower costs, flexibility, and speed to enable increased innovation and new business opportunities. Costs can be reduced by more effectively using the IT infrastructure, whether owned by the company or a third party, across multiple business units or companies.

However, the sharing of infrastructure and platform service resources introduces new risks resulting from the shift in responsibility for system support, access, and maintenance. Stakeholders will likely seek assurance that their data will continue to be as accessible, available, and secure in the cloud as it was when directly controlled by the company. Also, data storage and protection requirements will need to be defined in accordance with the

data type (e.g., financial or operational) and regulatory requirements and standards.

CAEs can help their companies evaluate how cloud computing can support the company's strategy in conjunction with other planned system changes. As their organizations look to take advantage of the cost savings associated with cloud computing, CAEs should assess how the provider will address risks, including:

- System maintenance (i.e., patch release and software updates)

- Remote and enhanced access (at the network, application, and database layers)

- Security of sensitive information, including employee and customer data, against loss, theft, or unauthorized access

- Exposure to unauthorized access or "hacking"

- Data contamination or data loss

- Data backup and recovery

- Change management

Navigating the regulatory and reputational labyrinth

Through good and bad economic times, overregulation ranks among CEOs' top concerns, according to results in our 2011 CEO survey. In today's changed business environment, there is an abundance of regulation as government policy-makers around the globe attempt to constrain risky activities, restore consumer and investor confidence, and change how governments are engaging the business community.

As a result, massive reform packages have been adopted in the United States and throughout the world. Companies moving into emerging markets will face both risks and opportunities as governments enact labor market reforms and approve tax incentives in hopes of creating competitive advantage.

However, nearly three-quarters of CEOs who responded to the annual PwC survey told us they would support new government policies that promote "good growth" that is economically, socially, and environmentally sustainable. Furthermore, 54% believe that collaborative government and business efforts will mitigate global risks, such as climate change.

The added responsibility of staying ahead of new regulation as it is enacted may challenge internal audit organizations' capacity. Sixty percent of our State of the Internal Audit Profession Study respondents expects an increase in attention to regulatory compliance programs in their audit plans. The complexity, diversity, and global reach of regulatory change have caused internal audit organizations to think creatively about how they address these risks and how they assess the response by management to the changing regulatory environment. Leading internal audit functions use internal legal and compliance resources as well as specific industry and global regulatory expertise from third parties.

The expanding reach of regulation and reform

The changing regulatory environment increases risk, as evidenced by a spike in FCPA enforcement and the enactment of financial and healthcare reform. When thinking about regulatory compliance, internal audit should be in a position to support the business and the audit committee.

The uncertainty and intensity of debate surrounding today's regulatory environment also requires companies to determine which new regulations are relevant to their business. This creates an opportunity for internal audit to engage with the company's general counsel and other compliance functions to help develop effective and efficient enterprisewide programs.

Meanwhile, despite a slowly recovering world economy, debt continues to rise, prompting countries to look to their tax structures for relief. To cope with tax, financial reform, and regulatory change, leading audit functions are:

- Performing global regulatory compliance risk assessments

- Taking an active role in assessing and developing corporate compliance programs with a focus balanced between compliance assurance and recommendations to improve the efficiency of processes and controls

- Monitoring new regulatory reform developments and reporting frequently to management and the audit committee on changes and how they affect the business

- Working with senior management and the company's legal and compliance functions to understand, assess and in some cases challenge the company's responses to regulatory change

- Monitoring proposed changes to tax laws that may provide incentives for investment and innovation

- Evaluating the impact of tax and regulatory changes on the business and assessing whether efficient and effective processes and controls are in place to support compliance

Sustainability

For participants in many industries, much of this recent regulatory movement has focused on a variety of sustainability concerns. Although still an emerging area for many companies, the pace of regulatory developments and the breadth of social issues they are intended to address show no sign of subsiding. Regulatory changes may have a profound effect on the environment, employee health, and workplace safety. As a result, companies are developing more robust processes to comply with these regulations and many are proactively using the sustainability movement to achieve a competitive advantage. Corporate social responsibility reports are becoming commonplace, and sales and marketing groups are making social responsibility statements in advertising and promotion materials. Companies should look closely at their ability to collect and report data to both regulatory agencies and the public to ensure that these assertions are supportable.

Internal audit should play an important assurance role in the design, implementation, and monitoring of these processes and controls.

Our State of the Internal Audit Profession Study indicates that corporate social responsibility and sustainability are growing areas of internal audit interest, with 35% of survey respondents indicating that their audit plans explicitly address these issues. Our discussions with leading CAEs also indicated increasing focus in these areas. While audit approaches are continuing to evolve, leading internal audit functions are actively engaging the business to better understand the risks and exposures. Approaches include:

- Compiling an inventory of regulatory reports and public statements and assessing the potential brand risks

- Performing data mapping exercises and assessing the processes and controls to ensure accuracy of data

- Assisting in the development of policies and procedures for review and approval of public statements about social responsibility

- Assisting in the development of regulatory compliance programs

> *"How to audit is simple, the question is 'what to audit?' You have to audit risk. There are four levels—risk that is unique to the process, to the organization, to the industry, and to the environment. Whether you are an eight-person or an eighty-person department, every audit you do should reconcile to one of these risks. Every internal auditor needs to know what can bring the organization to its knees."*
>
> Joel Kramer, managing director, MIS Training Institute

Adapt and align

In this constantly changing world, leaders of successful companies are continually adapting their strategies, organizations, and capabilities. At the outset, mention was made of the shifting priorities of global CEOs as they race to seize growth opportunities brought about by new technologies, innovation, and emerging markets. They are embracing change and recognizing that traditional approaches may not be effective in this fundamentally changed economy. For example, adapting to the new regulatory landscape and collaborating with governments in areas deemed critical for business growth was a key strategic imperative among CEOs in our global survey. They also recognize that different capabilities and new approaches to talent management will be required to succeed. In our 2011 CEO survey, "strategies for managing talent" was the area where CEOs anticipated the most change to their operating models, with 83% expecting at least some change. "Approach to managing risk" followed closely at 77%.

Just as company leadership is pursuing new approaches in a changing world, internal audit leaders must also adapt to a dynamic external environment and align internally with company leadership, their strategies, and priorities. New and innovative approaches to risk assessment, the use of technology, and cost-effective audit methodologies will continue to be important. However our experience tells us that the "softer" attributes of audit performance are increasingly critical to the success of internal audit functions.
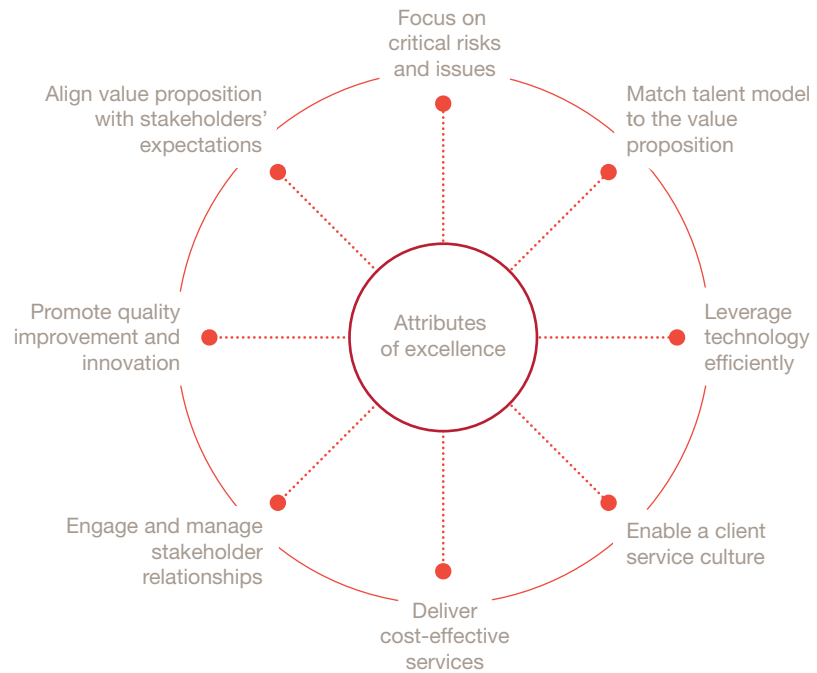
Communication and relationship management

Our discussions with leading CAEs and our experience in working with high-performing internal audit functions have consistently pointed to the importance of communication, relationship management, and establishing a "client service" culture and approach. Today's dynamic risk environment demands that internal audit plans and activities remain adaptive, relevant, and aligned with the needs and expectations of important stakeholders and the most critical risks of the company.

As such, these softer skills are vitally important to internal audit leaders' ability to stay close to company leadership and remain aligned with the key strategies and priorities of the company. Delivering value, in turn, will depend on internal audit leaders' ability to bring the right talent and expertise to establish credibility and earn a "seat at the table." As one Fortune 50 CAE remarked, "You're only as good as your last audit."

Although the leading CAEs have clearly employed relationship-based, "client service" approaches to ensuring the relevance and value of their functions, our survey results indicate a different view of these attributes across the profession. In 2010, we introduced the concept of eight attributes shared by high-performing internal audit functions, regardless of their scope of work (Figure 4). In our 2011 survey, we again asked participants to rate these attributes in order of importance. We also asked participants to identify those attributes where they plan to focus improvement efforts.

Figure 4. Internal audit's attributes of excellence

"It starts with relationships … with senior management, company leaders and the audit committee. This is a service function, and you do have clients. You do not subordinate your judgment, but you do serve. The major changes in the standards in the early 2000s reflect the service nature of internal audit. We talk about 'clients,' we talk about 'engagements'."

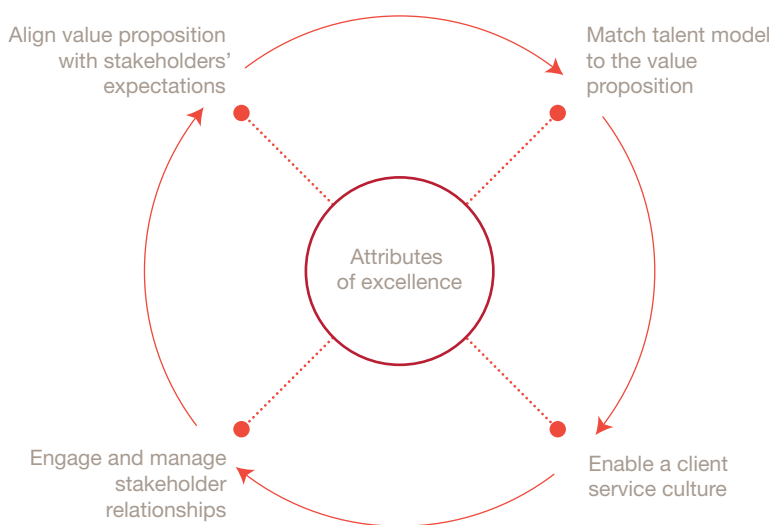Richard Chambers, president and CEO,
Institute of Internal Auditors

Once again, focusing on critical risks and issues and aligning internal audit's activities with stakeholders' expectations were identified as the most important attributes of a high-performing internal audit function. These attributes also were among the most cited for improvement efforts in the coming years. Most IA professionals would acknowledge, and we would agree, that these are critical factors in internal audit's ability to deliver value to their organizations.

But leaders in the profession also recognize that these attributes are often the result of a sustained focus on other enabling attributes. These include, engaging and managing stakeholder relationships and enabling a client service culture to maintain and improve internal audit's stature in the organization.

When we look across the broader population in our survey, these softer elements of relationship building and client service focus do not seem to be receiving the same attention as more technical elements. In our survey, these attributes were ranked at or near the bottom in terms of importance and improvement focus. Significantly more survey respondents are focused on improving approaches to leveraging technology and quality enhancement.

Our survey does indicate, however, a broadening of the interactions internal auditors are having with company leaders. While the highest level of inter-action remains with traditional finance and accounting leaders, our survey also shows a considerable level of contact with a company's operations leaders, such as business unit leaders, the chief operating officer, and chief information officer (Figure 6). Such relationships with operational leaders will be critical

Figure 5. Softer skills vital to remaining aligned with key priorities of the company

Align value proposition with stakeholders' expectations

Match talent model to the value proposition

Attributes of excellence

Engage and manage stakeholder relationships

Enable a client service culture

"I meet with the audit committee chair regardless of whether there is a formal meeting coming up and wouldn't hesitate to pick up the phone and call the audit committee chair if I needed to."

<div align="right">A leading CAE</div>

to internal auditors' ability to identify and respond to a broader range of risks and continue the migration from financial risks to more operational and strategic risks.

A common theme among the CAEs interviewed was the importance of relationships and developing a partnership with the business. Gone are the days when an annual risk assessment and a five-year rotational audit plan was a standard practice in the profession. In order for internal audit to return real value to the organization,
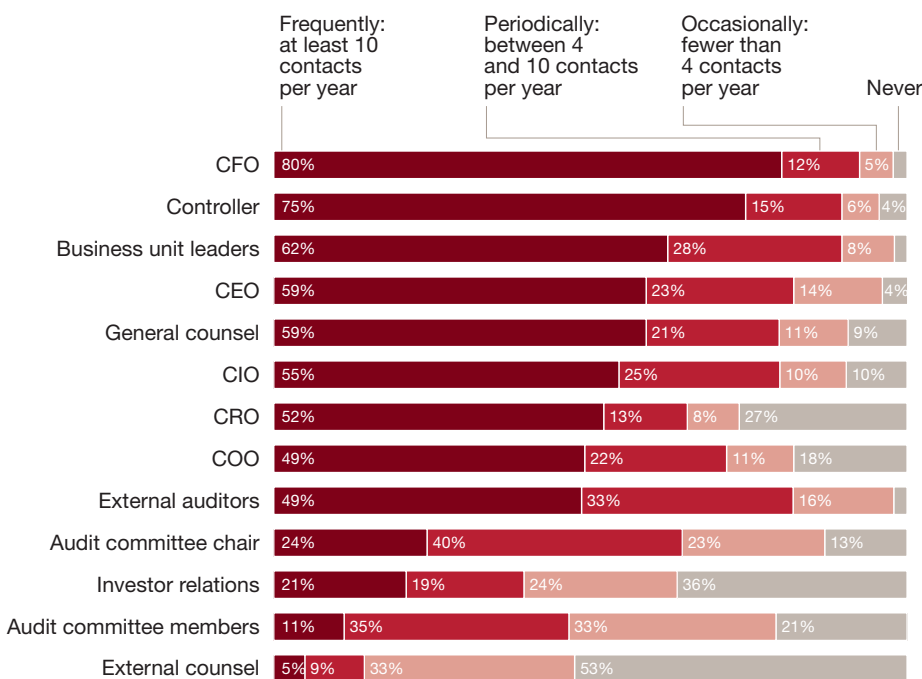
today's audit plans have to be flexible, responsive, and aligned with company strategy. Many CAEs have developed formal relationship management programs that align their departments with the business units of the company. Those that have been able to engrain this into their department's culture often find that their audit plans are more demand-driven by the business, as opposed to a supply of resources imposed upon the business. They often find themselves with a "seat at the table" for important strategic initiatives. Above all, these CAEs are

viewed as leaders in the company and an integral part of the senior management team.
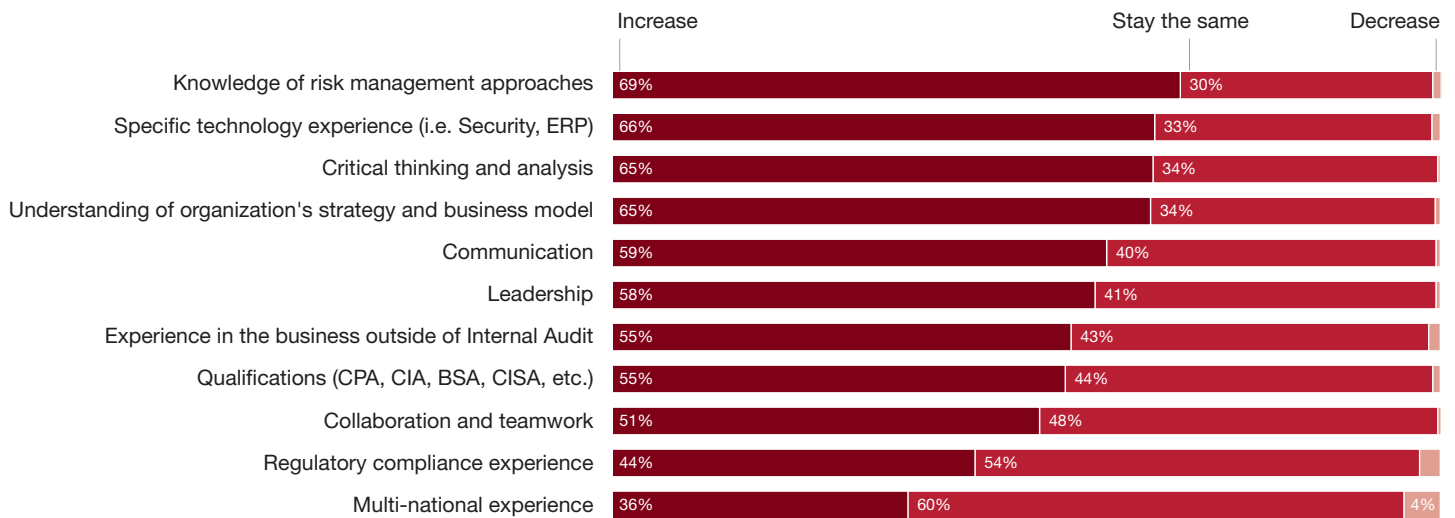
Leading CAEs also consider the audit committee as a main component of their relationship management programs, interacting with them frequently outside of scheduled meetings. Establishing a good working relationship with the audit committee cannot be over-emphasized. Because internal audit is well-positioned to see across the entire enterprise, it has the perspective and the objectivity to help the audit committee understand significant challenges and risks. Those who invest in relationships and leverage knowledge across the business will be best positioned to serve the audit committee in this capacity.

Some in the profession see a potential conflict between active relationship building and maintaining auditor objectivity and independence. Our belief is that meaningful and sustainable relationships are built on trust. For internal auditors, that trust is built through transparent and candid dialogue with stakeholders, and sharing a point of view that is not only fact based but also reflects an understanding of the business, its strategies, and its risks.

Figure 6: Apart from in-person, telephonic, or video-conference audit committee meetings, how much contact do you have with the following individuals?

	Frequently: at least 10 contacts per year	Periodically: between 4 and 10 contacts per year	Occasionally: fewer than 4 contacts per year	Never
CFO	80%	12%	5%	
Controller	75%	15%	6%	4%
Business unit leaders	62%	28%	8%	
CEO	59%	23%	14%	4%
General counsel	59%	21%	11%	9%
CIO	55%	25%	10%	10%
CRO	52%	13%	8%	27%
COO	49%	22%	11%	18%
External auditors	49%	33%	16%	
Audit committee chair	24%	40%	23%	13%
Investor relations	21%	19%	24%	36%
Audit committee members	11%	35%	33%	21%
External counsel	5%	9%	33%	53%

Figure 7: Indicate whether the need for the following capabilities and depth of knowledge will increase, stay the same, or decrease over the next 3 years.

Capability	Increase	Stay the same	Decrease
Knowledge of risk management approaches	69%	30%	
Specific technology experience (i.e. Security, ERP)	66%	33%	
Critical thinking and analysis	65%	34%	
Understanding of organization's strategy and business model	65%	34%	
Communication	59%	40%	
Leadership	58%	41%	
Experience in the business outside of Internal Audit	55%	43%	
Qualifications (CPA, CIA, BSA, CISA, etc.)	55%	44%	
Collaboration and teamwork	51%	48%	
Regulatory compliance experience	44%	54%	
Multi-national experience	36%	60%	4%

Bridging the skills gap

As company leaders seek new approaches to talent management to adapt to a dynamic environment, internal audit leaders must also devise creative approaches to acquiring the skills necessary to align with the diverse expectations of their stakeholders. Our survey indicates a clear recognition of the diverse mix of skills that will be required for internal auditors to succeed.

Participants rated the more technical skills of knowledge of risk management approaches and specific technology expertise as the most important skills needed over the next three years. However, these were closely followed by the softer skills that will be critical for success in this dynamic environment: critical thinking skills, understanding the strategy and business model, communication, and leadership (Figure 7). The relative importance of these skills underscores the notion that the auditor of the future will require agility, flexibility, and sharp business acumen to succeed.

Another striking aspect of the survey results for this question is the breadth and depth of the skills that are deemed necessary for success. For nine of the eleven capabilities surveyed, a majority of respondents said the need for those skills would increase over the next three years. These highly sought-after skills cover a broad range of technical and softer people skills; and therein lies one of the more significant challenges facing internal audit functions. The technical skill needs are becoming more specialized; the risks are more diverse; and management expectations are expanding at a rapid pace. One of the CAEs we interviewed put it this way:

What we need are people in IT who can also be project manager thinkers and challenge what's going on within the company. Do we have some of those people? Yes. Do we have enough of them? No.

How does internal audit overcome this challenge? Are there a sufficient number of people who possess this diverse set of capabilities? Can you train and develop it? The CAEs interviewed use a number of varied approaches to solving this issue:

- Delivering training programs that balance technical and professional development courses, with an increasing emphasis on interpersonal and leadership skills, including communication and presentation skills; coaching and people development capabilities; management and leadership approaches; negotiation skills; and specific industry training.

- Sourcing specialized expertise from external service providers, either on a recurring basis or in a transitional mode. Even larger organizations that seek to build a particular skill may team with a third party to deliver audits jointly and provide on-the-job training in the process.

- Recruiting leaders from the business into internal audit, either on a permanent or "guest" basis.

- Establishing hiring strategies that shift focus away from solely accounting and technical backgrounds to those with a more well-rounded business experience. As audit plans broaden in scope, some are looking to nontraditional backgrounds such as engineering and manufacturing.

Although these times demand creative approaches to skill development and talent management, leading organizations have found that the most effective and lasting training and personal development occurs on the job. As one CAE put it, "being an internal auditor is like getting a paid MBA." But the internal audit MBA does not come from sitting in a classroom; rather it is only achieved by those who get out into the business, forge relationships with leaders across the organization, and develop a thorough understanding of the strategy, risks, and operating model of the company.

For that reason, many of the CAEs interviewed have implemented formal relationship management programs for their teams, from the newest staff members to the most experienced directors. For some, relationship building has been built into their staff's performance expectations and personal development plans. Through this form of on-the-job training, internal auditors can develop the business acumen, strategic thinking, interpersonal communication, and leadership skills that are vital to delivering value and staying relevant.

Internal audit should think in high-def, not analog

Internal audit organizations fared relatively well during the 2008–09 financial crisis. Spending was up relative to other company functions, and internal auditors retained their stature with the audit committee and executive management. But as companies regain confidence in their ability to grow, many may decide to take a fresh look at internal audit to see whether they're getting a good return on the investment, said Richard Chambers, president and CEO of the Institute of Internal Auditors.

"If you don't have passion, energy, and enthusiasm, nothing happens," he said. "If you are a CAE and you just see it as a job, you are in the wrong job. Don't just go through the motions."

In a recent interview with PwC, Chambers predicted that the existing situation for internal auditors is likely to "accentuate the expectations gap," adding that the fix rests with individual audit organizations.

"Chief audit executives need to do an inventory of their stakeholder expectations. You need that candid assessment with senior management and the audit committee," he said.

Where to start? Build relationships. By sharing leading trends and best practices with company leaders, internal audit is better able to hold on to the stature it has acquired in recent years.

A proponent of co-sourcing as a way to augment missing skills and capabilities, Chambers noted that it's virtually impossible for internal audit to satisfy the full spectrum of stakeholder expectations without a co-sourcing strategy.

"You have to get out there and find partners who can bring you a hub and spoke type of model to bring that expertise as you need it," he said. "That's something I would encourage anybody to do."

Chambers also cautioned internal audit organizations to guard against creating the perception that internal audit does not fully grasp the business. He recommended that CAEs take the following steps:

- Complete an inventory of your stakeholders' expectations. Make sure you understand their views on:
  - What risks should be addressed by internal audit?
  - Where does internal audit add value to the business?
  - Is internal audit seen as a source of talent?
  - Where is it that internal audit needs to step up?
- Be transparent with management. For instance, share the department's progress in implementing leading internal audit practices and your risk assessment perspective.
- Develop and broaden relationships with the audit committee. Be sure they understand the range of services internal audit can offer. "I believe a lot of audit committees are constituted with members brought in for financial controls acumen. They may not have an appreciation for what internal audit can offer. They may not know what internal audit can do beyond traditional work," Chambers said. "I do believe you do have to market internal audit. That is part of your responsibility. They have to know what internal audit can do."

Chambers also recommended that internal auditors move beyond where they are most comfortable. He said those organizations that want to enhance their effectiveness should persuade company leadership to involve internal audit on the front end when improving processes and controls.

"If as an internal auditor you sit out the engineering process as processes are developed and then tell them later things were done wrong, that sounds too much like the 'gotcha' auditor," he said. "There are two reasons why internal audit is not at the table—because we were asked and declined, or we were never asked. Our job is to get to the table."

What this means for your business

The curtain is rising.
Are you ready?

"If we come in every day and do our jobs as we think we know how to do them, we'll be obsolete very quickly."

A leading CAE

A year ago, we introduced the concept of an internal audit 2.0 to start organizations thinking about change. We also said, "the time to act is now, while internal audit has management's attention." We believe internal audit is still in the spotlight, but the pace of change has accelerated once again. Now, companies are poised to move quickly to seize the growth opportunities that lie ahead. In addition to dealing with a more intense regulatory environment and reputational risks stemming from the use of technology, internal audit must be razor sharp if the profession is to maintain the stature it earned during the past decade.

So the primary questions for an internal audit leader to reflect upon include: Are you keeping pace? Are you taking the right steps and making the right adjustments to stay relevant? Are you helping your company play both offense and defense? Are you creating a client service culture that is founded on strong relationships?

Internal audit leaders should be asking themselves these and other questions about the value they are delivering to their organizations. We also suggested questions that executive management and audit committees should be asking themselves about internal audit. We hope these questions will encourage a productive dialogue about internal audit organizations.

Where will you be three years from now?

Despite the uncertainty of the global economic recovery, companies are wasting no time charting new courses for sustainable growth by migrating overseas to new and emerging markets.

Internal audit leaders in banking have seen a dramatic change in their regulatory environment since the financial crisis, while those in other industries cautioned that regulatory compliance risk will continue to increase for multinational companies.

Reputational risks could be even greater than they are today because of the effect of new media and communications technologies.

In a departure from previous years, several leading internal audit practitioners from across a range of industries were interviewed to get a sense of the practical steps they are taking to increase their relevance in this changing environment. In summary, these are the actions most often heard from internal audit functions facing challenging times:

- Recruiting audit leaders from the business

- Sourcing externally for missing capabilities

- Enhancing training and development programs to improve the softer skills

- Continually improving executive and audit committee reports to provide better context and insight

- Maintaining close working relationships with the audit committee chair

- Participating in discussions about major growth, cost, and compliance initiatives

- Engaging legal and compliance expertise to address the complex array of global compliance risks

- Partnering with internal and external technology specialists to address rapidly changing technical and business risks

In our view, it's imperative for internal auditors to look closely at how their own organizations are structured. They should also take a hard look at their agendas for the coming year and think about how practices can be implemented to help embrace change.

Leading internal audit functions look beyond the confines of their department and seek partners both within and outside the business. Whether a function of 100 or more auditors, or a much smaller shop, audit teams of every size can benefit from some form of co-sourcing and an active interaction with the business and compliance functions to identify and manage significant risks. That's our most significant takeaway from speaking with leaders in the profession.

Questions to ask about internal audit

Chief audit executive	Executive management	Audit committee
Relevance and value		
• Have I engaged and worked with management and the audit committee to frame expectations? • Have I taken action to adjust capabilities and approaches to today's business environment? • Do I really have a seat at the table? If I don't, what would it take to get one?	• Is the cost versus value of my internal audit department appropriate? • Do I look to internal audit to sort through the toughest issues and initiatives? • Do I view internal audit as an integral part of my executive leadership team? • Do we have relevant performance criteria and expectations that are commensurate with relevant peers?	• Does internal audit have a clear point of view about risk and the control environment? • Is internal audit forward looking when it comes to risk? • Have we defined clear performance expectations and compensation criteria for internal audit?
Business alignment		
• Am I leveraging my unique vantage point within the company to provide a clear point of view on the risks associated with the changing business environment? • Do I have the capabilities to provide relevant insight and advice to stakeholder groups? • Am I taking steps to prepare my people for what they will be doing two to three years from now?	• Of my top 10 risks and issues, how many is internal audit actively involved in? • Do I view internal audit as an enabler in executing our business strategy? • Am I leveraging internal audit for talent development?	• How is internal audit providing a clear point of view on our top 10 critical risks and issues? • Is internal audit providing insight into emerging risks and trends?
Client service culture		
• Am I continually improving the content and format of executive reports? • Do my training plans include improving business acumen and leadership skills? • Am I focused on systematically building relationships?	• Am I getting pragmatic business insights and advice from internal audit? • Are we, as a company, committed to internal audit excellence?	• Do I trust internal audit to make the really tough calls? • Is internal audit making a concerted effort to engage me? • Are audit committee reports relevant, concise, and insightful?

To have a deeper conversation about how this subject may affect your business, please contact:

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