PULSE OF INTERNAL AUDIT

Navigating an Increasingly Volatile Risk Environment
Survey Demographics

Survey Conducted Oct. 2014
- 8th consecutive year
- 370 responses
- 63% Public/Private companies
- 84% CAEs and Directors (311 responses)
- 92% internal audit managers or above

311 Responses From CAEs and Directors
- 63% Public/Private companies
- 22% Public Sector

Industry
- 28% Finance and Insurance
- 14% Manufacturing
- 10% Educational services
- 7% Healthcare and social assistance

Large Companies
- 55 Fortune 500
- 53% $1B or more revenue

Key Themes

- Emerging and Evolving Risks
- Linking Risks and Audit Coverage
- Navigating an Escalating Talent Shortage
- Parting Thoughts: Navigating Thought Leadership
CONTINUOUSLY ASSESSING EMERGING AND EVOLVING RISKS
Assessing Emerging and Evolving Risks

• A high priority with which CAEs struggle
• Often necessitates “connecting dots”
• Is vital to “auditing at the speed of risks”
Identifying Emerging Risks is Critical: But Confidence is Lacking

<table>
<thead>
<tr>
<th>Organization’s ability</th>
<th>Identify</th>
<th>Respond</th>
</tr>
</thead>
<tbody>
<tr>
<td>Extremely confident</td>
<td>3%</td>
<td>4%</td>
</tr>
<tr>
<td>Very confident</td>
<td>32%</td>
<td>31%</td>
</tr>
<tr>
<td>Moderately confident</td>
<td>45%</td>
<td>42%</td>
</tr>
<tr>
<td>Slightly confident</td>
<td>15%</td>
<td>17%</td>
</tr>
<tr>
<td>No confidence</td>
<td>5%</td>
<td>6%</td>
</tr>
</tbody>
</table>

52 percent of CAEs consider identifying emerging risks to be their biggest challenge in 2015.


Source: The Pulse of Internal Audit survey: © 2015 The IIA Audit Executive Center. Total may not equal 100% due to rounding.
## Continuously Assessing Emerging and Evolving Risk

<table>
<thead>
<tr>
<th>Methodology</th>
<th>Extensively Utilized</th>
</tr>
</thead>
<tbody>
<tr>
<td>Periodic Manual Monitoring of KRI's</td>
<td>9%</td>
</tr>
<tr>
<td>Using Technology to Continuously Monitor KRI's</td>
<td>2%</td>
</tr>
<tr>
<td>Periodically Interview Management to Identify Changes in the Organization's Risk Profile</td>
<td>33%</td>
</tr>
<tr>
<td>Initiate Formal Updates of the Internal Audit Risk Assessment &amp; Audit Plan</td>
<td>29%</td>
</tr>
<tr>
<td>Initiate Informal or Ad Hoc Updates of the Internal Audit Risk Assessment &amp; Audit Plan</td>
<td>26%</td>
</tr>
<tr>
<td>Periodically Update Risk Assessment Based on Changes to Risk Ratings Identified During Ongoing Audit Operations</td>
<td>22%</td>
</tr>
</tbody>
</table>

Taking Action When Risks Emerge is Vital!

70% of CAE’s viewed cyberattacks as a high or critical priority –
AEC Pulse of Internal Auditing

Yet!

Only 53% say auditing cybersecurity risk is part of this year’s plan – Protiviti 2015 IA Capabilities and Needs Survey Report

• Assess the existing risk assessment maturity
• Develop/refine processes to identify and report on emerging risks
• Assess the existing process for updating the annual audit plan
• Obtain stakeholders input on the need for frequent updates
• Develop/ refine audit reporting to demonstrate a stronger link between changes to:
  • the organization’s risk profile
  • associated changes to the audit plan
LINKING RISKS & AUDIT COVERAGE
Linking Risks and Audit Coverage: The Paradox of “Structural Expectations”

• Stakeholders often expect base level of coverage:
  • Financial risks
  • Regulatory risks
  • Compliance risks

• Once base is addressed:
  • Operating risks
  • IT risks

• Only then, is there interest in strategic and business risks

• The paradox:
  • Base level coverage often provides the lowest perceived value

Source: The Pulse of Internal Audit survey: © 2015 The IIA Audit Executive Center. Total may not equal 100% due to rounding.
Delivering Internal Audit Value: According to Grant Thornton - CAE’s Believe

They Add Value by:

1. Identifying improvement opportunities
2. Mitigating risk
3. Increased efficiency
4. Stronger corporate governance
5. Stronger financial controls compliance

Barriers Include:

1. Budget constraints (60%)
2. Talent quality or capacity (47%)
3. Focus on financial controls and compliance (43%)
4. Perception of internal audit (40%)
5. Organizational politics (40%)

Source: “Competing Priorities: Are CAE and audit committee priorities in sync?” © 2015 Grant Thornton LLP
Audit Plan Coverage in 2015

Source: The Pulse of Internal Audit survey: © 2015 The IIA Audit Executive Center. Pulse survey respondents were asked to estimate the distribution of their audit plan coverage. This figure reflects a summary of the data. Total may not equal 100% due to rounding.
LINKING RISKS & AUDIT COVERAGE
Linking Risks and Audit Coverage

Conceptually:

Risk → Drive → Audit Coverage

In Practice:

Resources → Drive → Audit Coverage

Source: The Pulse of Internal Audit survey © 2015 The IIA Audit Executive Center. Total may not equal 100% due to rounding.
The Outlook for Internal Audit Resources in 2015 Remains Strong

- **Projected Changes in Budgets From 2014-15:**

<table>
<thead>
<tr>
<th></th>
<th>Increase</th>
<th>Stable</th>
<th>Decrease</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall</td>
<td>41%</td>
<td>50%</td>
<td>9%</td>
</tr>
<tr>
<td>F500</td>
<td>43%</td>
<td>53%</td>
<td>4%</td>
</tr>
</tbody>
</table>

- **Extent of Budget Increases:**

<table>
<thead>
<tr>
<th>Range</th>
<th>All</th>
<th>F500</th>
</tr>
</thead>
<tbody>
<tr>
<td>1-5%</td>
<td>31%</td>
<td>29%</td>
</tr>
<tr>
<td>6-10%</td>
<td>33%</td>
<td>42%</td>
</tr>
<tr>
<td>11-15%</td>
<td>14%</td>
<td>17%</td>
</tr>
<tr>
<td>Over 15%</td>
<td>22%</td>
<td>12%</td>
</tr>
</tbody>
</table>

Source: "The Pulse of Internal Audit: © 2015 The IIA Audit Executive Center"
Linking Risks & Audit Coverage: Key Imperatives

• Undertake a comprehensive assessment
• Develop an audit plan based on the “real risks”
• Identify areas in where resources and expertise gaps exist
• Formulate strategies for addressing gaps
• Have candid conversations with management and the audit committee regarding:
  • Resource shortfalls
  • Expertise gaps
  • Risks that may fall victim
  • A plan of action
• Develop a long-term strategy for addressing gaps
• Don’t let the “tail wag the dog”

“Disclosing the gaps in risk coverage and discussing the resources needed to address the gaps is essential.”

- Joe Steakly, CAE of HCA
PCAOB CREATING DOWNSTREAM IMPACTS ON INTERNAL AUDIT
Practice Alert 11
- Issued in October 2013
- In response to “significant auditing practice issues observed” related to ICFR audits
- Directed at firms auditing ICFR

PA 11 is having a significant “downstream” impact on:
- Management
- Audit committees
- Internal audit

Documentation has taken center stage

CAE’s have reported widespread lack of reliance on internal audit’s work

External Audit Scrutiny Is On the Move: Changes Observed Since 2013

<table>
<thead>
<tr>
<th>Area of Focus</th>
<th>Percentage Increase</th>
</tr>
</thead>
<tbody>
<tr>
<td>Management’s documentation of controls</td>
<td>65%</td>
</tr>
<tr>
<td>Internal audit’s workpaper documentation</td>
<td>55%</td>
</tr>
<tr>
<td>Testing scope</td>
<td>56%</td>
</tr>
<tr>
<td>Risk evaluation</td>
<td>36%</td>
</tr>
<tr>
<td>Internal auditor competence</td>
<td>27%</td>
</tr>
<tr>
<td>Internal audit’s objectivity</td>
<td>22%</td>
</tr>
</tbody>
</table>

Internal Audit in Publicly Traded Companies:

• **95%** are assisting management with ICFR documentation
  ○ **51%** very or extremely involved

• **65%** experiencing increased scrutiny expect external audit fee increases (result of PA 11)

• **55%** experiencing increased scrutiny expect an increase in direct assistance hours

*Source: The Pulse of Internal Audit survey; © 2015 The IIA Audit Executive Center.*
Questions CAEs should Pursue with Stakeholders:

• Does the audit committee understand:
  • where external audit is/is not, placing reliance on internal audit work?
  • the rationale behind the reliance parameters?
• Does the CAE and the audit committee understand how external audit evaluates the competence and objectivity of internal audit?
• Does the external auditor have competence- and objectivity-related discussions with the audit committee?
  • If not, does the audit committee know to initiate the conversation?
NAVIGATING AN ESCALATING TALENT SHORTAGE
Internal audit “will face tougher competition to recruit and retain the top talent needed to meet the increased complexity of regulatory changes, emerging risks around cybersecurity, IT, and the growing demands of stakeholders…”

Navigating an Escalating Talent Shortage

Skills Rated Essential to Audit Function’s Ability to Perform its Responsibilities

<table>
<thead>
<tr>
<th>SKILLS CONSIDERED VERY OR EXTREMELY ESSENTIAL</th>
<th>RATE</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Analytical/Critical Thinking</td>
<td>96%</td>
</tr>
<tr>
<td>2 Communication Skills</td>
<td>96%</td>
</tr>
<tr>
<td>3 Business Acumen</td>
<td>80%</td>
</tr>
<tr>
<td>4 Industry-specific Knowledge</td>
<td>69%</td>
</tr>
<tr>
<td>5 Accounting</td>
<td>48%</td>
</tr>
<tr>
<td>6 Data Mining and Analytics</td>
<td>44%</td>
</tr>
<tr>
<td>7 IT (general)</td>
<td>43%</td>
</tr>
<tr>
<td>8 Risk Management Assurance</td>
<td>40%</td>
</tr>
</tbody>
</table>

## Navigating an Escalating Talent Shortage

### Skills Gaps Identified

<table>
<thead>
<tr>
<th>RANK</th>
<th>AREAS OF HIRING DIFFICULTY</th>
<th>AREAS OF SKILLS DEFICIENCIES</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>IT (general)</td>
<td>Quality Controls, e.g. Six Sigma</td>
</tr>
<tr>
<td>2</td>
<td>Cybersecurity and Privacy</td>
<td>Data Mining and Analytics</td>
</tr>
<tr>
<td>3</td>
<td>Data Mining and Analytics</td>
<td>Cybersecurity and Privacy</td>
</tr>
<tr>
<td>4</td>
<td>Industry-specific Knowledge</td>
<td>Forensics and Investigations</td>
</tr>
<tr>
<td>5</td>
<td>Analytical/Critical Thinking</td>
<td>IT (general)</td>
</tr>
</tbody>
</table>

Navigating an Escalating Talent Shortage
PwC’s View

The talent gap is “fueling a poor perception of internal audit’s relevance and value: 65% of stakeholders who do not find value in the internal audit functions cite talent as a top barrier.”

- PwC -

Internal audit functions providing significant value have more diversified skill sets:

- Business continuity – 84% vs 70%
- Data privacy – 80% vs 64%
- Specialized IT – 77% vs 61%
- Data analytics – 72% vs 59%
- Supply chain – 69% vs 48%

Navigating an Escalating Talent Shortage

Techniques Employed by Pulse Survey Participants to Address Skill Gaps

Recruiting staff from outside of internal audit, offering on-site training, and outsourcing cited as three effective approaches:

- Cybersecurity and privacy:
  - 37% outsource
  - 23% recruit
- Data mining and analytics:
  - 9% outsource
  - 23% recruit

Navigating an Escalating Talent Shortage

Key Imperative – 4 Step Process

• **Step 1:** Create an organizational risk profile

• **Step 2:** Assess team skills

• **Step 3:** Identify skills gaps and develop strategies to close them

• **Step 4:** Address strategic business risks and the effectiveness of risk management
PARTING THOUGHTS: NAVIGATING NEW THOUGHT LEADERSHIP
It’s “Whitepaper Season” for Internal Audit

• At least 7 “whitepapers” were released in March:
  • *Pulse of Internal Audit* – The Audit Executive Center
  • *Intersecting Roles* – The Center for Audit Quality and the AEC
  • *2015 State of the Internal Audit Profession Study* – PwC
  • *2015 Internal Audit Capabilities and Needs Survey* – Protiviti
  • *Competing Priorities: Are CAE and audit committee priorities in sync?* – Grant Thornton
  • *Strengthen Audit Committee Value: A 10-Step Approach* – TeamMate®
  • *Metrics Matter – How Internal Audit Can Help Organizations assess performance measurement* - EY
Questions?

The Institute of Internal Auditors

Richard Chambers, CIA, QIAL, CGAP, CCSA, CRMA
President & Chief Executive Officer
richard.chambers@theiia.org

@RFChambers