Preparing for the Future

Imperatives for Internal Audit

In 2018 and Beyond

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CIA, QIAL, CGAP, CCSA, CRMA
President and CEO
The Institute of Internal Auditors
Overview

• Internal Audit in 2018
  – The CEO’s View
  – On the Audit Committee’s Agenda
  – Internal Audit’s Focus

• Pervasive Disruption

• Imperatives for 2018 and Beyond

• Parting Thoughts
How CEOs See the World

- Majority anticipate improved global economic growth
- But they also see threats to that growth

<table>
<thead>
<tr>
<th>Top risks</th>
<th>Response</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Over-regulation</td>
<td>42%</td>
</tr>
<tr>
<td>2. Terrorism</td>
<td>41%</td>
</tr>
<tr>
<td>3. Geopolitical uncertainty</td>
<td>40%</td>
</tr>
<tr>
<td>4. Cyber threats</td>
<td>40%</td>
</tr>
<tr>
<td>5. Availability of key skills</td>
<td>38%</td>
</tr>
<tr>
<td>6. Speed of technological change</td>
<td>38%</td>
</tr>
</tbody>
</table>

- Heightened risks
  - Terrorism/cyber threats not in top 5 at beginning of 2017

Source: From PwC’s 21st CEO Survey: The Anxious Optimist in the Corner Office © 2018 PwC
Audit committee questions for internal audit:

- Is the audit plan risk-based and flexible?
- Does it adjust to changing business and risk conditions?
- What has changed in the operating environment?
- Is the company sensitive to early warning signs regarding safety, product quality, and compliance?
- What role should internal audit play in auditing the culture of the company?

“The audit committee should work with the chief audit executive to help identify the risks that pose the greatest threat to the company’s reputation, strategy, and operations and to help ensure that internal audit is focused on these key risks and related controls.”

– KPMG Audit Committee Institute
### Top Areas of Focus

<table>
<thead>
<tr>
<th>Area</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Financial-related</td>
<td>22%</td>
</tr>
<tr>
<td>2. Operational</td>
<td>17%</td>
</tr>
<tr>
<td>3. Compliance/Regulatory</td>
<td>16%</td>
</tr>
<tr>
<td>4. IT and Cybersecurity</td>
<td>16%</td>
</tr>
<tr>
<td>5. Risk Management</td>
<td>6%</td>
</tr>
<tr>
<td>6. Governance and Culture</td>
<td>4%</td>
</tr>
</tbody>
</table>

Source: 2018 North America Pulse of Internal Audit: The Internal Audit Transformation Imperative
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## CAE’s View of the Top 5 Risks

<table>
<thead>
<tr>
<th>Rank</th>
<th>Risk</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Cyber (prevention/recovery)</td>
<td>64</td>
</tr>
<tr>
<td>2</td>
<td>Compliance/Regulatory</td>
<td>46</td>
</tr>
<tr>
<td>3</td>
<td>IT (not otherwise included)</td>
<td>45</td>
</tr>
<tr>
<td>4</td>
<td>Management of 3rd Party Rel.</td>
<td>36</td>
</tr>
<tr>
<td>5</td>
<td>Operational</td>
<td>35</td>
</tr>
</tbody>
</table>

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Disruption: Internal Audit Is Not Immune

- Lists significant industry change, business model disruption, and technology disruption as among most likely trends over the next year.

NACD 2017-18 Public Company Governance Survey

- Roughly 1 in 3 directors indicate their business models will be disrupted in the next five years.

McKinsey

- The rapid speed of disruptive innovations and new technologies is the top-rated risk for 2018.

NC State University ERM Initiative

“Disruption, or radical change driven by external factors, is no longer episodic. In fact, it’s rapid fire, from disruptive innovation that creates a new market, to economic volatility, new regulation or even a catastrophic event.”

Source: “Evolving Internal Audit to Respond to Business Disruptions,” PwC
Responses to Disruption

Meaningful collaboration with other lines of defense

Flexible planning/resource allocation

Prepared and adaptive (anticipate and react)

Assessing the risk of additional future disruption

Flexible talent management

56%

45%

43%

43%

36%

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Internal Audit Imperatives for 2018 and Beyond

1. Maintain a Laser Focus on the Horizon
2. Take the Offense in the War for Talent
3. Sharpen and Deploy the Best Navigation Tools
4. Be a Beacon for Transformation
5. Sail *Toward* the Storms
Maintain a Laser Focus
On the Horizon
Focus on the Horizon

The Challenge for Internal Audit

• Risks are emerging at warp speed
• Focusing on the horizon is essential to avoiding the post-crisis question:

"WHERE WERE THE INTERNAL AUDITORS?"

The Imperative

• In focusing on the horizon:
  – Continuously assess risks
  – Identify and swiftly respond to emerging risks
  – Deploy “Doppler Radar” to identify approaching storms
Focus on the Horizon: Strategies for Success

Understand the challenge

• How dynamic is your industry?
• Open a dialogue with management and the audit committee
  – You need stakeholder support to focus on the horizon

Key Indicators of Emerging Risks

• Economic forecasts
• Known strategic business risks facing your company
• New initiatives being planned
• Legislative and regulatory outlook
• Threats or opportunities facing your industry
• Primary competitors and their challenges
• Risks emerging as headlines via traditional or social media
Take the Offense

In the War for Talent
The War for Talent

The Challenge for Internal Audit
• New risks mandate expertise in multiple areas
• Experts are in high demand . . .
• And they demand the best opportunities

The Imperative
• To engage in the war for talent:
  – Understand stakeholder needs and expectations
  – Assess existing competencies
  – Develop and deploy strategies, including
    • Talent sourcing
    • Talent development
    • Succession
  – Continuously motivate and reward talent
Talent Gaps

In acknowledging talent gaps, CAEs say they are somewhat, very, or extremely likely to...

- 72% CAEs who say they have talent gaps to fill
- 52% Perform work only to the extent of internal competencies
- 37% Delay work until competencies are developed
- 28% Exclude area from audit plan

Source: 2018 North America Pulse of Internal Audit: The Internal Audit Transformation Imperative
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**The War for Talent: The Battlefield in 2018**

### What Skills Are in Demand?

<table>
<thead>
<tr>
<th>Skills Being Actively Recruited</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Analytical/Critical Thinking</td>
<td>66%</td>
</tr>
<tr>
<td>2 Communication</td>
<td>61%</td>
</tr>
<tr>
<td>3 Business Acumen</td>
<td>48%</td>
</tr>
<tr>
<td>4 Data Mining and Analytics</td>
<td>45%</td>
</tr>
<tr>
<td>5 Accounting and Finance</td>
<td>43%</td>
</tr>
<tr>
<td>6 Innovative Thinking</td>
<td>41%</td>
</tr>
<tr>
<td>7 Basic IT Knowledge</td>
<td>38%</td>
</tr>
<tr>
<td>8 Industry-Specific Knowledge</td>
<td>37%</td>
</tr>
<tr>
<td>9 Process Improvement</td>
<td>37%</td>
</tr>
<tr>
<td>10 Persuasion and Collaboration</td>
<td>34%</td>
</tr>
</tbody>
</table>

### How Hard Are They to Find?

<table>
<thead>
<tr>
<th>Skills Most Difficult to Recruit</th>
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<tbody>
<tr>
<td>1 Cybersecurity and Privacy</td>
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<tr>
<td>2 Data Mining and Analytics</td>
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<td>3 Industry-Specific Knowledge</td>
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<tr>
<td>4 Innovative Thinking</td>
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<td>7 Governance and Culture</td>
</tr>
<tr>
<td>8 Business Acumen</td>
</tr>
<tr>
<td>9 Fraud Investigations and/or Auditing</td>
</tr>
<tr>
<td>10 Risk-Management Assurance</td>
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Sharpen and Deploy the Best Navigation Tools
Deploy the Best Navigation Tools

The Challenge for Internal Audit

- Resource pace of growth has slowed
- Environment is more complex
- Expectations at an all-time high

The Imperative

- Strive to audit smarter, better, and faster – and continuously deliver impact
- Deploy leading technology and practices to enhance capacity, effectiveness, and value
Extent of Deployment in 2018

<table>
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<tr>
<th>Implementation of Technology Solutions</th>
<th>Full or Partial</th>
</tr>
</thead>
<tbody>
<tr>
<td>Electronic workpapers</td>
<td>77%</td>
</tr>
<tr>
<td>Data Analytics</td>
<td>62%</td>
</tr>
<tr>
<td>Automation of routine internal audit tasks (e.g. robotics process automation)</td>
<td>18%</td>
</tr>
<tr>
<td>Automation of analysis of evidence (e.g. automated judgement, artificial intelligence)</td>
<td>13%</td>
</tr>
</tbody>
</table>

- New technologies create agile and future-focused functions
- Today’s tools of the trade:
  - Audit management systems
  - Data analytics
- Tomorrow’s tools of the trade:
  - Robotics
  - Artificial intelligence (AI)
- Deploy solutions that will yield dynamic results/insights

Source: 2018 North America Pulse of Internal Audit: The Internal Audit Transformation Imperative
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Be a Beacon
For Transformation
Support Enterprise Innovation

The Challenge for Internal Audit

• New market and value networks are disrupting at record pace
• Established market-leading firms, products, and alliances are facing lethal risks
• Innovation is often the only path forward

The Imperative

• Champion transformation built on innovative thinking/actions
• Provide stakeholders insight into best innovation processes/frameworks
• Shine a light on:
  – Disruptive threats
  – Targets for transformation
  – Risks and controls throughout transformation processes

“According to the consulting firm McKinsey, 70% of business transformations fail. . . . By inserting itself at 7 steps of the transformation process and addressing these risks, internal audit can assist management in beating the odds and achieving a successful transformation.”

- James E. Schulien
“Seven Steps to Transformation”
Internal Auditor magazine, August 2017
Key Steps to Build an Innovative Mindset

• Empower staff to identify problems, risks, threats
• Analyze first: Make sure you’re solving for the right problem
• Understand what is driving decision to innovate
  – Technological disruption
  – Shareholder, regulatory pressure
  – Disruptive innovation
  – Staying ahead of the competition
• Understand your corporate culture
• Start small and benchmark
• Innovation must fit the overall business strategy
The Challenge for Internal Audit

- Tendency to avoid controversial topics, such as:
  - Executive compensation
  - Legal compliance
  - Corporate culture
  - Harassment/misconduct (gender, ethnicity, etc.)
- Looking the other way only compounds risks
- Some internal auditors experience “courage deficit”

The Imperative

- Internal auditors must:
  - Follow the risks – wherever they are
  - Be willing to push on closed doors
  - Summon the courage to sail toward (and even chase) the storms
Sail Toward the Storm: Attributes of Courageous Internal Auditors

- **6 attributes of courage**
  - Overcome fear
  - Be passionate
  - Persevere in the face of adversity
  - Stand up for what’s right
  - Expand your horizons
  - Face suffering with dignity or faith

- **Speak truth to power**

Parting Thoughts:

Looking back, we should have looked ahead

Looking ahead, don’t look back with any regrets
Thank You

The Institute of Internal Auditors

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