

2015 State of the Internal Audit Profession Study

Internal audit strategic planning

Making internal audit's vision
a reality during a period of
rapid transformation



68%

of companies have gone through or are going through a business transformation in response to market shifts; another 12% anticipate doing so in the next 18 to 24 months

73%

of companies indicate that organizational risks are increasing

Source: PwC 2015 State of the Internal Audit Profession Study



The pace of change in most businesses is steadily increasing, and companies face new and emerging risks as they implement strategies to combat challenges and capitalize on new opportunities. Globalization, the capital markets, the evolving and ever-more-stringent regulatory environment, and innovations in technology are pressing companies to undertake strategies such as entering new markets, expanding into new industries, launching new product lines, transforming their business models, and dramatically reducing cost. Such changes bring with them new and more-complex risks that companies' risk management functions, including internal audit, must understand and proactively address.

In support of that notion, the PwC 2015 *State of the Internal Audit Profession Study: Finding True North in a period of rapid transformation* determined that, to mitigate risk and improve controls in today's constantly changing environment, internal audit must evolve along with the business, as opposed to react to the changes. In this survey of more than 1,300 chief audit executives (CAEs) and their stakeholders, 55% of respondents

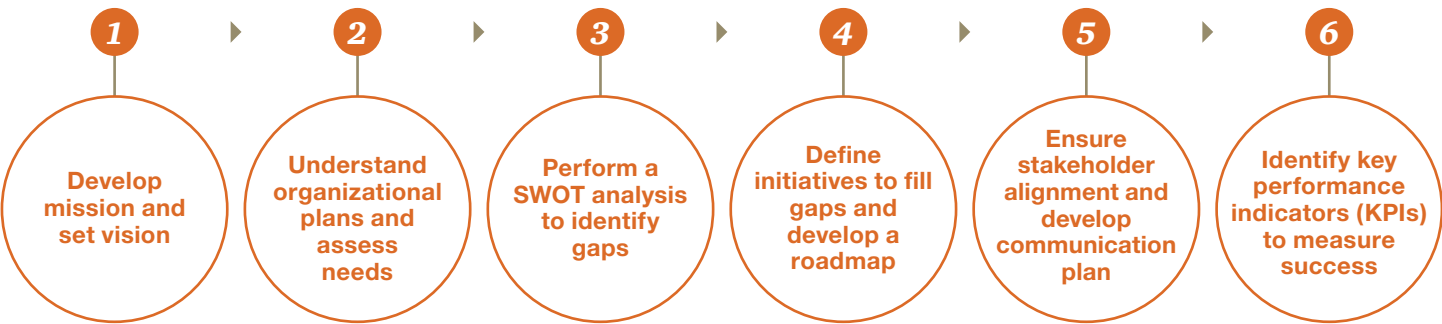
expect that within the next five years, internal audit's value proposition will be to both serve proactively and provide value-added services and prospective strategic advice on risks to the business—through efforts well beyond the ordinarily expected effective and efficient execution of the audit plan. In contrast, today only 11% say that that is the value internal audit brings. Clearly, expectations are shifting.

The shifts are not being promoted by stakeholders alone. Leading internal audit executives, too, are pushing their functions to better identify and more effectively respond to their dynamic risk landscape. Such rising expectations are causing internal audit to evaluate whether it is capable of evolving as expected and if not, how it intends to build that capability. Internal audit will have to evaluate both current and proposed future-state capacity, skill sets, geographic coverage, and

timing needs. Just as senior executives go through a strategic planning process to define corporate strategy and make decisions about resource allocation, internal audit executives need their own strategic planning process to determine (1) the requirements for accomplishing their vision and (2) the steps they must take to get there. A strategic plan provides a clear prescription for internal audit's evolution for maintaining its relevance and value as the business transforms.

Internal audit departments differ from company to company, and therefore each may want to customize its approach, but the process for developing an internal audit strategic plan consists of six steps (Figure 1). Further discussion of the objectives and tasks within each step follows.

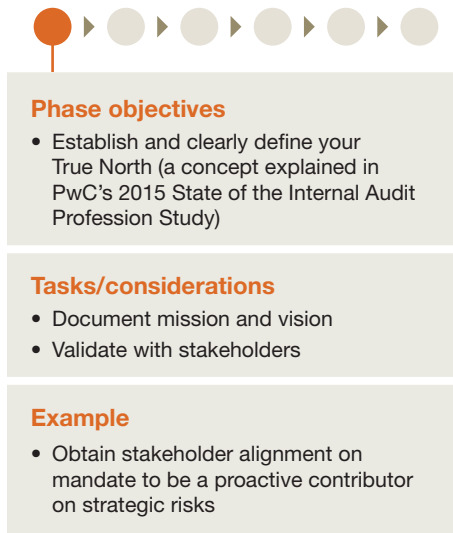
Figure 1. Internal audit's strategic planning process: phases and objectives



9% of stakeholders say internal audit's current mandate is to be proactive and to provide value-added services and prospective strategic advice on risk; **45%** say that's where internal audit should be in five years

Source: PwC 2015 State of the Internal Audit Profession Study

1. Develop mission and set vision



Effective planning begins with goal setting. At most companies, the internal audit function has an established mission and vision that has developed over time and that gets revisited periodically as the organization goes through change. Organizational goals and objectives are actively changing, and internal audit must respond by planning how it will deliver future value to the organization. Internal audit's mission and vision together focus on the question: "What is the current mandate for the internal audit function, what should it be, and what is likely to be expected in the future?"

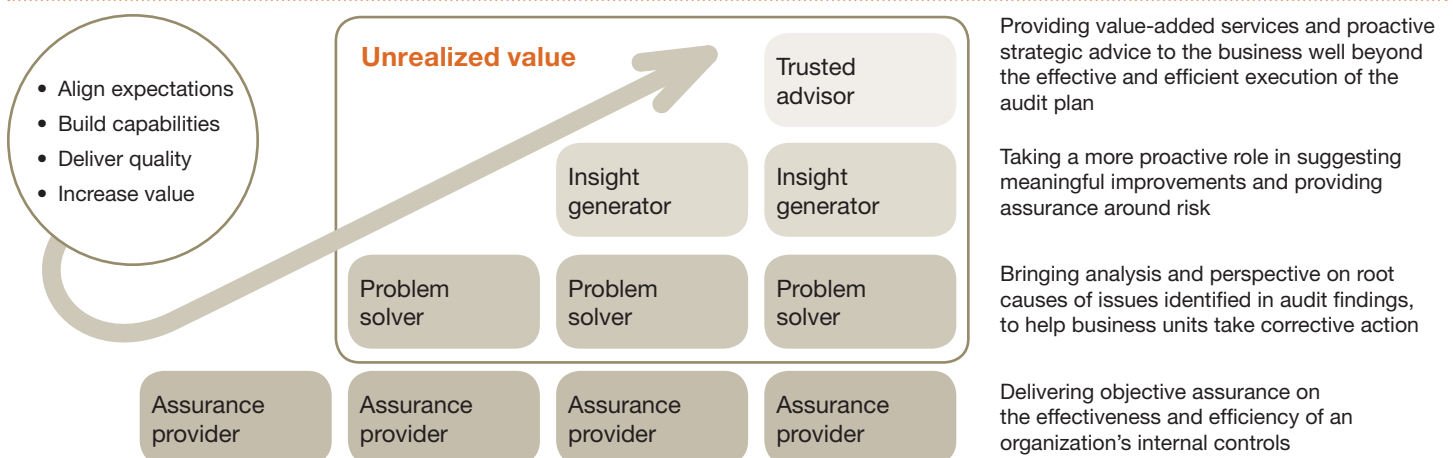
In 2013, PwC introduced the continuum between an assurance provider, that delivers objective assurance and executes on a typically more-traditional audit plan, through a trusted advisor, that provides value-added services and and proactive

contributions to strategic risk for the business—beyond mere execution of the audit plan. To complete the strategic planning process requires that Internal Audit understand where along that continuum internal audit stakeholders expect, or desire the function to be performing.

Considering whether the function's purpose, authority, responsibility, and structure are the right ones for delivering the value the organization seeks represents a critical first step in effective strategic planning.

Revisiting and validating the function's mission and values is critical to providing a sound basis for internal audit's establishment of a strategic plan. The final element is communication of that mission and vision to stakeholders, ensuring that stakeholders are aligned with internal audit leadership's view of the mission and future vision.

Figure 2. The journey to capture unrealized value



47%

of internal audit functions seen by stakeholders as providing significant value provide proactive perspectives and make recommendations for internal control before risk occurrence. This compares with **19%** of all other internal audit functions.

67%

of companies say they manage risk well; **55%** say they anticipate risk well.

68%

of board members and **42%** of management report their internal audit function delivers significant value.

2. Understand organizational plans and assess needs



Phase objectives

- Obtain an understanding of the organization's key initiatives and the changing risk landscape during the next two to five years

Tasks/considerations

- Assess:
 - New technologies
 - New geographies
 - Emerging risks
 - New competition
 - Costs, pricing, or other financial-performance changes anticipated
 - Change in business model
 - Current vs. future capabilities

Example, cont.

- The organization is planning to launch a new externally facing portal, allowing customers and vendors to interact directly with the company in a self help capacity, rather than the current model which requires customers to engage through a call center or third party intermediary.

Once there is alignment on the internal audit mandate, the function must now go through the process of understanding what that mandate means for its organization and function. By way of communication with the organization's stakeholders and key leaders, internal audit should come to better understand the company's two- to five-year plan in terms of answers to the following questions.

- What are the organization's key initiatives?
- Are new technologies expected to be developed or implemented?
- Is the company looking at entry or expansion into new markets?
- What other emerging risks are likely to arise in the next two years?
- Are changes anticipated in organizational structure?
- Is the company expecting to change its business model or the products or services it offers?

- How are budgets and incentives tied to the company's strategies and initiatives?

Following the understanding, a tactical alignment between the organization's plans and initiatives and the proposed Internal Audit plan using the "What *should* we do?" mindset should occur. This will develop the areas that should be part of the short and long term internal audit plan as they align to the initiatives, strategies and resultant risks of the organization. It is only at this point that internal audit management can now begin the next phase—the process of comparing the function's current capabilities with future capability needs in order to become able to deliver on the mission and vision agreed to during phase 1. This process is executed through an assessment in the form of an analysis of functional strengths, weaknesses, opportunities, and threats (SWOT).

43% of companies say internal audit skill sets are barriers to its ability to contribute to the organization's strategic initiatives

Source: PwC 2015 State of the Internal Audit Profession Study

3. Perform a SWOT analysis to identify gaps



Phase objectives

- Complete a gap analysis between current and longer term internal audit capabilities and long-term needs

Tasks/considerations

- Evaluate across people, process, and technology the capabilities necessary to deliver on future expectations

Example, cont.

- As the organization increases its direct to customer interaction and opens its on line presence, does the internal audit function have the skills to advise the business around the technological implementation, privacy and security concerns, and identify other emerging risks resulting from this change in strategy?

This SWOT analysis should consider factors internal to the audit function and factors external with stakeholders.

The SWOT analysis should make evaluations across people and structure, process, and technology.

People and structure

As expectations of the internal audit function evolve and as organizations venture into new risk environments, internal audit's talent model is changing. Leading internal audit functions are looking at creative initiatives that focus on identifying and using the right resources at the right costs. The key question that all internal audit functions should be asking within their strategic plan is: "Do we have the right mix of talent within the internal audit function to add value to the organization today and deliver on our mission, and do we have a strategy to evolve our talent model to keep up with the changes in the organization and deliver on our future vision for the function?"

In establishing the right talent strategy for an internal audit function, organizations are considering a mix of approaches, including hiring and retention strategies, rotational programs, and sourcing through external organizations. For hiring and retention strategies to be effective parts of the strategic plan, the function must first understand and define which

skills it desires to maintain in house and build a recruitment, training and retention model to achieve this goal.. Rotational programs are often used by leading internal audit functions to supplement specific technical skills resident within the organization. Many top internal audit functions are looking to build partnerships with a third party provider who can provide specific skill sets needed to fill gaps in the talent model, variable staffing to manage peaks and valleys of workloads, and a partner to support the function as it navigates the changing risk landscape and strives to keep the talent model ahead of, or at least on the curve.

The main challenge in executing a highly effective talent strategy is balancing between effective risk coverage and cost. Few functions can afford to hire all the skills needed to react to and proactively add value to the organization and must therefore build an adaptable and flexible talent model that can meet the changing demands of the organization while managing overall cost. Additionally, training programs could ensure that staff are receiving the right type of training and experiences to deliver the value expected under the mission and vision.

In addition to people, the function should also consider structure. Where does the function align within the organization? Does the internal audit function and plan mirror the

38% of companies say internal audit performs well at using technology effectively in the execution of audit services

Source: PwC 2015 State of the Internal Audit Profession Study

Leading organizations are seeing increased alignment between internal audit and the first two lines of defense including creating common definitions on risk, greater transparency and collaboration on projects. These efforts result in improved risk mitigation and organizational efficiency.

operations of the organization? To whom does the CAE report? Do the answers to these questions create barriers to fulfilling the mandate defined in the mission and vision?

Process

Stakeholder management and business alignment are not new concepts for internal audit functions, but their application in the context of strategic planning can change the internal audit process. As pressure increases for internal audit functions to evolve with the business, process changes become necessary to achieve the desired evolution. For example, internal audit functions have historically used a continuous feedback loop, but that may require refinement to ensure the loop is designed to anticipate—and respond to—critical and emerging business risks. As internal audit moves from reactive to proactive, changes in the timing of stakeholder discussions and engagement with initiatives much change. Internal Audit must become involved in transformational opportunities and initiatives as they are happening as opposed to reacting to breakdowns or events after the occurrence. Strategies for these changes would include:

- revisions to the ‘annual’ risk assessment process to a more frequent and fluid process

- participation in key stakeholder meetings to discuss organizational changes and initiatives
- increased use of data analytics to identify outliers and risk trends
- closer alignment with ERM and the other lines of defense

Technology

Advances in technology have transformed both the audit universe and the way that leading internal audit functions deliver value to their organizations. When companies utilize technology in new ways, the risk landscape changes; and internal audit must respond with the right capabilities to stay relevant. It must also capitalize on those new technologies so as to become a more efficient and value-adding function.

The internal audit function’s use of technology in recent years has transformed approaches to risk management and auditing. Data analytics, data visualization, and monitoring capabilities have enabled leading internal audit functions to broaden coverage and increase their ability to efficiently provide assurance over business operations. The advent of electronic work papers and work flows has enabled leading internal audit functions to more efficiently oversee fieldwork and issues management. Electronic systems have also served to achieve business

alignment when technology is used in conjunction with the business. Thinking about technology enablers within the internal audit function is a necessary component in the creation of a strategic plan. The other key element for consideration within technology is the capabilities on the team related to technology. As the technological world evolves at a rapid pace Internal Audit is continually challenged to keep up. Consideration should be given to the areas of cyber risk, cloud, social media and to establishing a talent strategy which will allow the internal audit function to maintain the skills required to add value to the business and maintain alignment and relevance to the business in the face of constantly evolving risks.

Upon completion of the SWOT analysis and with a baseline established, the internal audit function should now consider the future needs and develop a gap analysis. Building the bridge between the current state and the future state will serve as input for the roadmap the internal audit function develops to successfully execute against the mission, vision, and mandate.

4. Define initiatives to fill gaps and develop a roadmap



Phase objectives

- Identify and prioritize needs and approach to close gaps and create a road map to get there

Tasks/considerations

- Outline and prioritize strategies to close gaps in the areas of training opportunities, hiring strategies, market coverage, sourcing needs, and technology improvements; and create a timeline and set milestones to execute against

Example, cont.

- Given the breadth of skills required to address the emerging risks resulting from the change in strategy, evaluate options to close identified gaps such as hiring strategies, training opportunities, and sourcing; include timelines and cost considerations

The process of comparing current-state SWOT with the future state will pinpoint gaps that must get closed in order to be able to deliver on the mandate and fulfill the mission and vision. Such gaps serve as the basis for developing a set of internal audit initiatives covering the three major areas of execution: people, process, and technology.

Roadmap

The initiatives should be prioritized and set into a timeline that is realistic to achieve yet doesn't hinder the ability to deliver on the mission and vision. Developing a roadmap that defines how and when the internal audit function will hit specific milestones and achieve its objectives will help ensure successful execution of the strategic plan (Figure 3). The roadmap can also further efforts involving business alignment and stakeholder management.

Figure 3: Example roadmap

FYXX Initiative	FYX1				FYX2			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
1. Strategic plan performance measurement and reporting (generally applicable to all IA functions)								
a. Assess IA organizational structure to determine need for incremental skills and external partnerships								
b. Develop performance metrics to drive internal and external reporting								
c. Periodically report strategic plan progress to AC and Management								
d. Collaborate with business leaders performing Enterprise-wide Risk Assessment								
e. Integrate IT and data analytics capabilities into existing IA processes								

FYXX Initiative	FYX1				FYX2			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
2. Develop capability to support the organizational online strategy (specific to company initiatives)								
a. Expand Internal Audit relationships with key project stakeholders								
b. Integrate Internal Audit resources into existing project teams for on-going oversight								
c. Identify and retain data privacy specialists								
d. Engage Cybersecurity specialists to perform periodic threat and vulnerability assessments related to new portal								
e. Establish data governance capabilities								
f. Retain resources with Identity Management experience								

5. Ensure stakeholder alignment and develop a communication plan



Phase objectives

- Obtain buy-in on the initiatives

Tasks/considerations

- Socialize initiatives, including timeline, costs, and priorities

Example, cont.

- Once determination of which skills will be hired, training and retained in house and which will be sourced through rotation or third parties, obtain buy in for the incremental costs or shift in current planned spend required to meet this emerging need. This is not generally done at each decision point, but rather as part of quarterly or semi-annual updates to senior management and the Audit Committee.

With a roadmap and key initiatives defined, validation with stakeholders is necessary to determine whether the business is aligned and whether it supports the proposed direction. That support might come at a cost, and the ability to create a business case with shared return on investment may be needed. Moving forward, the creation of an ongoing communication

plan for the internal audit strategic plan and related initiatives is critical to maintain alignment. The ongoing communication plan should be a fluid process that uses business touch points on a regular and frequent basis and has a continuous feedback loop to improve the execution and evolution of the plan.

6. Identify key performance indicators (KPIs) to measure success



Phase objectives

- Create KPIs to monitor and measure success against the identified initiatives

Tasks/considerations

- Create measurable and monitorable metrics to track progress
- Share with stakeholders to get agreement

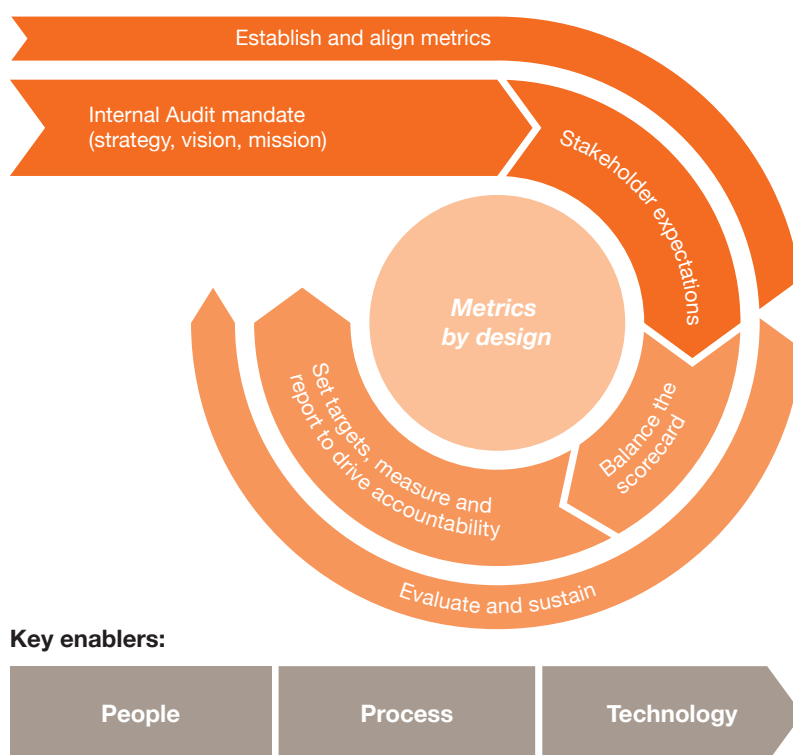
Example, cont.

- Develop KPIs to measure performance against the goal of aligning IA resources to support the company's online strategy. Establish milestones for hiring resources or engaging third party consultants with specialized skill sets to support the initiative.

Monitoring progress against the strategic plan is critical to success. In September 2014, PwC released a white paper *Metrics by design: A practical approach to measuring internal audit performance*. The paper focused on the ways leading organizations are redesigning their balanced scorecards to measure success. Upon receiving stakeholder alignment with the initiatives and elements of the roadmap, KPIs should be developed for ongoing monitoring

and communication on the progress of the internal audit initiatives. This process is not linear—there will be continuous changes throughout all phases required for internal audit to be agile in their plan and strategies. Applying metrics by design in the context of strategic planning is an efficient approach for monitoring the success of the function's strategic planning process and achieving sustainable internal audit value into the future.

Figure 4: Common metrics approach



Making it happen



Even though most internal audit functions have identified the need to evolve their department in some way—by managing new risks, adding new skills, collaborating with other risk functions, and applying technology—few have a purposeful plan in place to attain those objectives. Without such a plan that clearly defines and captures an internal audit function’s True North, it is difficult to stay on a clear path forward which is aligned to internal audit’s mission and vision, and ensure that the necessary tactical steps are taken to evolve the function.

Attainment becomes even harder when internal audit is surrounded by change and business transformation. If internal audit fails to evolve the function in pace with the business it supports or have a talent model which is flexible enough to keep pace with the changing risk profile and needs of the business, it risks becoming less relevant to stakeholders and less effective for the business. A strategic plan provides the means whereby internal audit can look forward at future needs and translate those needs into actionable steps it will take to meet them. With its true north defined and its strategic plan as its guidepost, internal audit can launch initiatives and make resource decisions at a pace that helps ensure it is a valuable contributor to the business in this time of rapid business change.

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

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