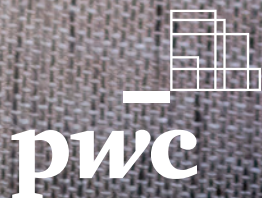


Rising to the challenge

Keeping pace with
stakeholder expectations

Internal Audit. Expect more.



Raising the bar

A route map for delivering Internal Audit excellence

As the risk landscape expands, it is providing both challenges and opportunities for organisations and while being ready to respond is essential, it's not easy.

Stakeholder expectations of Internal Audit are rising and at the same time Internal Audit's mandate is becoming more complex. Internal Audit has emerged as a critical lever for change and a key means of giving boards the confidence to deal with the demands of a dynamic marketplace.

Since 2005, our State of the Internal Audit Profession Study has been gathering insights globally from Heads of Internal Audit (HIAs) and their stakeholders, including senior management and board members.

As expectations rise, PwC's trend data shows that Internal Audit has increased the value it delivers. While this is a positive trend, our research indicates that there is room for improvement as stakeholder perception of Internal Audit performance has remained flat.

16%

of stakeholders consider their Internal Audit function as a trusted adviser.

11%

of stakeholders say IA is providing value-added services and proactive advice.

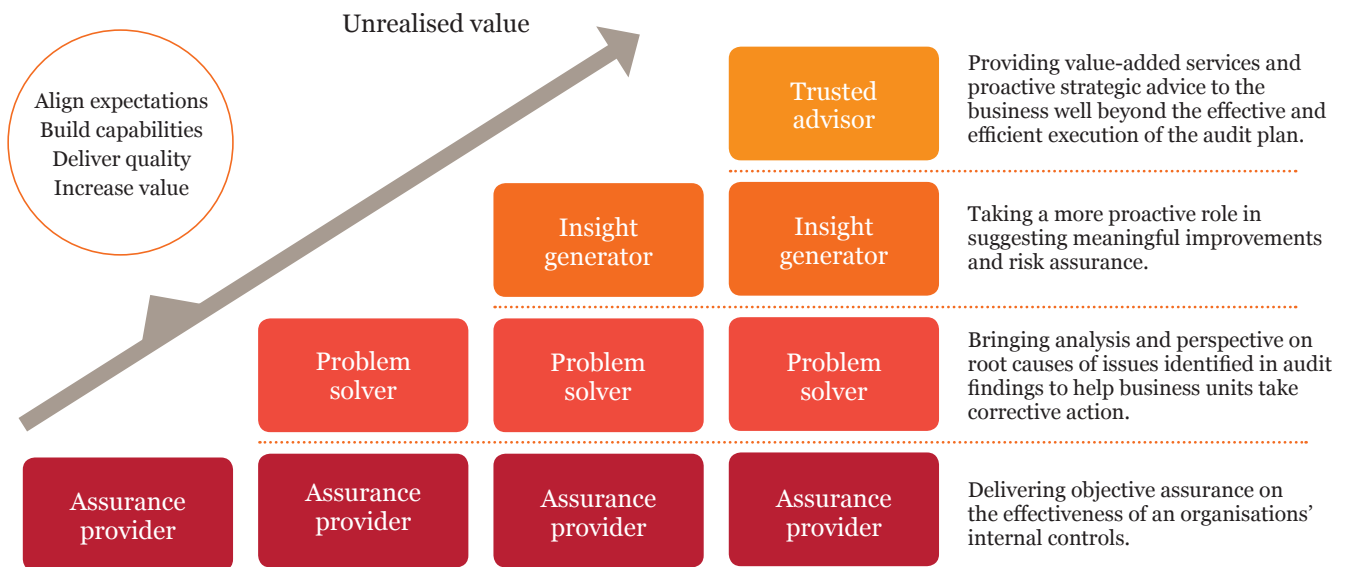
66%

of HIAs indicate they will be evolving their delivery model to provide value added services in the next five years.

From assurance provider to trusted adviser

Stakeholders also shared that the highest performing Internal Audit functions, those adding the greatest value to their organisations, are not only delivering on their core mandate of providing assurance, but are aspiring to deliver value as a trusted adviser, a concept first introduced by PwC in 2013 and further explained in figure 1.

Figure 1: Internal Audit functions classified by stakeholders

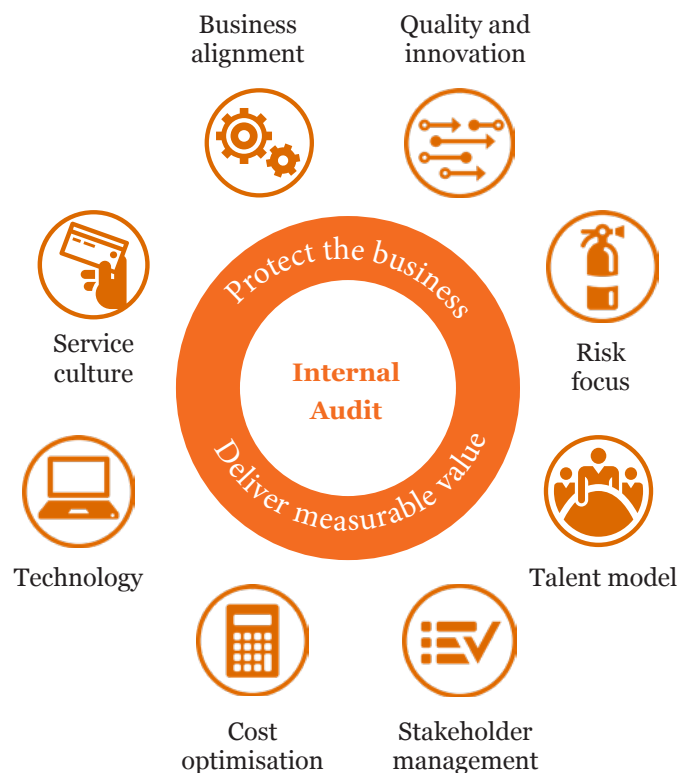


Attributes of Internal Audit Excellence

Our research, discussions with stakeholders and HIAs and our experience delivering Internal Audit services, have consistently pointed to the importance of eight core attributes (figure 2) shared by leading Internal Audit functions, regardless of their mandate, scope of work, or size. PwC introduced these attributes in 2010 and our research continues to tell us that there is a strong correlation between stakeholders' perception of value and Internal Audit's performance against these attributes.

In this document we explore the eight Attributes of Internal Audit Excellence and how using them as a route map can help Internal Audit functions raise the bar and deliver excellence to all of their stakeholders.

Figure 2: Attributes of Internal Audit Excellence



1

Business alignment



Our 2016 State of the Profession study reveals that one-third of stakeholders who perceive their Internal Audit function as providing assurance level service do not feel they are performing well against this attribute.

What good looks like

Internal Audit has a clear understanding of the strategic direction of the company and the expectations of its stakeholders. It aligns its scope and resulting audit plan with the business direction in the context of these expectations. The function maintains alignment through strategic planning and coordination with other lines of defence. Internal Audit incorporates stakeholder expectations into its mission and vision and clearly defines the value it will deliver to the organisation. Measurement of progress towards the mission and vision and resulting actions to align with the business are communicated. To deliver on this attribute, Internal Audit routinely stays abreast of business goals, objectives and decisions, as well as keeping a pulse on the company through its regulatory filings, competitor and industry information, and insights gained through participation in strategic discussions.

Delivering maximum value

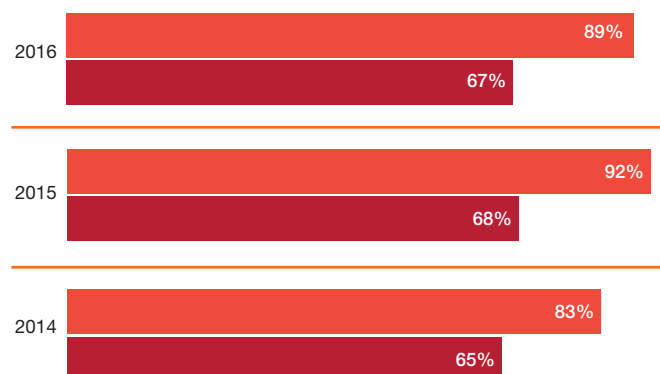
Our point of view

Alignment with the business is critical to Internal Audit achieving its mandate to serve the company.

There's much discussion about Internal Audit leadership having a 'seat at the top table', but it's what HIAs do with that seat at the table that changes the perception of stakeholders, many share our belief that this is best accomplished through regular attendance in strategic meetings. To capitalise on this opportunity HIAs need to have made a clear distinction between assurance providers and trusted advisors and a conscious decision to be the latter rather than the former. Rather than remaining on the periphery of the discussion and focusing resources on auditing risks and controls once the business has moved forward, they should see their role as being to 'see round corners' offering a proactive point of view, sharing insights on how to navigate the most critical risks as strategic decisions are made and aligning their talent model to address risks as they unfold.

Figure 3: How Internal Audit is performing

% of companies where Internal Audit is performing well at business alignment



Source: PwC State of the Internal Audit Study, 2014-2016

■ Trusted advisor
■ Assurance provider

2

Risk focus



Trusted advisors do not limit their audit plans based on their in-house capabilities, they go outside to find the right resources to address the risks facing the business.

What good looks like

Internal Audit takes a holistic view of risks that considers internal, external and emerging risk factors. The function has a thorough understanding of the company's risk culture, the risk appetite of the business, and regulatory and legal requirements. Internal Audit invests the appropriate time to perform a dynamic risk assessment that encompasses top-down, strategic perspectives focused on identifying the most critical risks facing the business today and in the future. This strategic top-down risk focus is often calibrated with a bottom-up approach centred on where risks are manifesting themselves in the business today. For certain areas, such as IT risks, a second-tier, more specific risk assessment is performed, leveraging subject matter experts to pinpoint where these risks may materialise. In anticipation of business changes and at regular intervals, the risk assessment is refreshed to keep the audit plan focused on the most critical and value added areas.

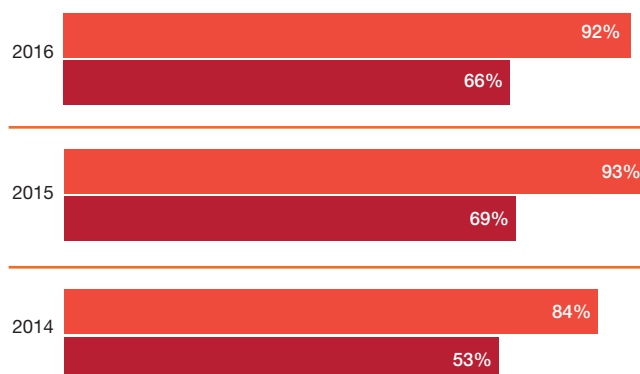
Delivering maximum value

Our point of view

The risk assessment process is not only a requirement to meet IIA standards, but foundational to how Internal Audit develops both its strategic vision and audit plan. How a risk assessment is carried out, the frequency with which it is updated, coordination with other lines of defence and the resulting audit approach can make all the difference in the value Internal Audit delivers. In our experience those Internal Audit functions delivering the greatest value are continuously evaluating the risk profile of the organisation and anticipating changes versus reacting to them. These functions understand the various second line of defence activities and their respective maturities. An Internal Audit function operating as assurance provider will evaluate the Enterprise Risk Management function, adapt the Internal Audit plan to focus on management's response to risks and then refine the plan to focus on the residual risk. They focus on risks from an inside point of view. Trusted advisors, on the other hand, are forward-looking, focused on the future and gathering internal and external points of view by researching industry trends and leveraging subject matter expertise. They prioritise the risks that matter, incorporating these factors into their audit plan and sharing the insight gained with the business, enabling the business to more proactively manage or take advantage of the risks.

Leveraging the power of data analytics, reporting and visualisation tools, they influence business decisions, and adapt audit coverage to deliver the greatest value.

Figure 4: How Internal Audit is performing
% of companies where Internal Audit is performing well at risk focus



Source: PwC State of the Internal Audit Study, 2014-2016

Trusted advisor
Assurance provider



Stakeholder management

Trusted advisors deliver added value by driving accountability across their teams, structurally aligning individual team members to specific stakeholders, providing clear expectations to expand interaction beyond the audit and routinely measuring results and driving actions to improve performance.

What good looks like

Internal Audit effectively understands and manages relationships with a broad set of stakeholders. It understands its responsibility in supporting alignment across the three lines of defence alongside the move from combined or integrated assurance to coordinated assurance as well as its role in enhancing collaboration and coordinating assurance across the organisation. Stakeholder expectations are well understood across the function and communication protocols in place. The Internal Audit strategic plan is calibrated to align with these expectations. A shared definition of value is measured through one-on-one feedback sessions and surveys allowing for timely action on feedback. Internal Audit communicates with impact, leading value-driven conversations. An effective stakeholder management plan often enhances business alignment and elevates Internal Audit's awareness and resulting focus on critical risks.

Delivering maximum value

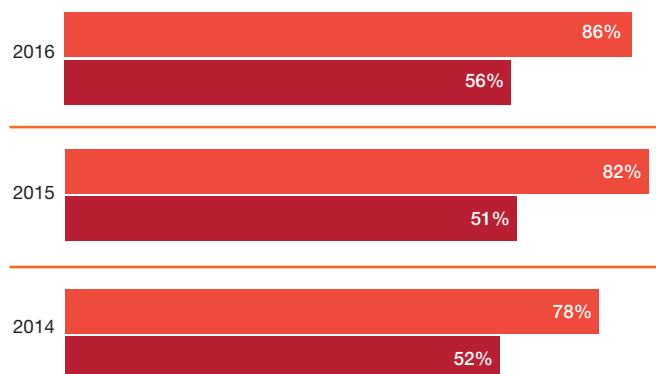
Our point of view

It's our belief that a strategically designed communication plan lies at the core of effective stakeholder management and, whilst many Internal Audit functions believe they communicate well, in our experience there is often limited interaction outside of these activities. This results in misalignment between expectations of what Internal Audit should be delivering and what it's actually delivering. There is undoubtedly merit in the standard activities of sharing the audit plan, holding audit kick off meetings, reporting on findings and observations, following up on resolution of audit issues and listening to the auditees throughout the process.

What's more, Internal Audit team members enhance their understanding of the business and its risks through these interactions and are, in turn, able to be more responsive and agile in adapting audit plans and talent models as new risk areas emerge.

Figure 5: How Internal Audit is performing

% of companies where Internal Audit is performing well at stakeholder management



Source: PwC State of the Internal Audit Study, 2014-2016

■ Trusted advisor
■ Assurance provider

4



Cost optimisation

To deliver at a higher value level, Internal Audit functions need to be re-thinking the audit equation from risk assessment to reporting, innovating their processes and investing in data analytics, technology and tools.

What good looks like

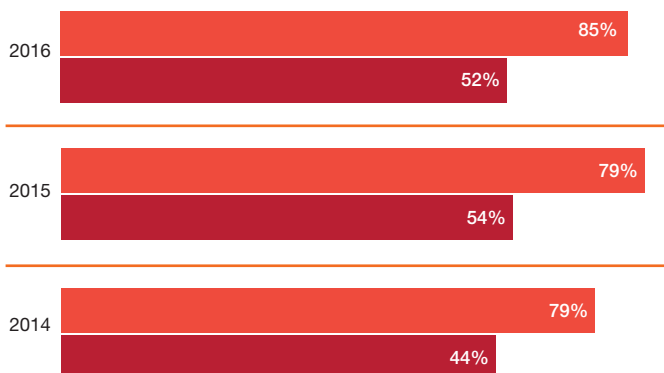
Internal Audit optimises cost by delivering efficient and value-added services through robust, well communicated audit methodology and processes. Methodology is regularly evaluated, the use of analytics is embedded throughout, and processes are standardised and simplified to maximise effectiveness while optimising cost. Flexible staffing models are inclusive of: internal and external resources; various staff levels; strategically positioned resources (globally, if applicable); and specialised skillsets (such as IT and sector expertise). Processes are in place, such as real-time reporting, to measure productivity and cost-effectiveness of services. Investments in Internal Audit infrastructure are aligned to the same metrics used by other service functions within the business.

Delivering maximum value

Our point of view

While the business environment and resulting risks continue to evolve dramatically, we're not seeing Internal Audit budgets increasing at the same pace. This is regularly driving Internal Audit leaders to find ways of doing more with the same or less budget and we have found that the way Internal Audit functions address these realities is often indicative of where they fall on the value spectrum. Assurance providers are cost conscious and focused on monitoring budgets and staffing levels, limiting expenses and taking corrective actions. Advancements in technology mean they are also looking to enable processes with better audit management systems and adapt audit strategies to incorporate the power of data analytics within traditional sampling methodologies. This is not simply to automate isolated audit procedures, but to transform their function in order to unlock real value across the entire Internal Audit lifecycle. Those doing this successfully are able to hone in on residual risk by gaining a deeper understanding of second line of defence activities, embedding data analytics to monitor the more traditional risks and creating more cost-effective approaches to audit more complicated risk areas. They do this by employing flexible staffing models that more effectively match the supply of specialised skills against demand.

Figure 6: How Internal Audit is performing
% of companies where Internal Audit is performing well at cost optimisation



Source: PwC State of the Internal Audit Study, 2014-2016

■ Trusted advisor
■ Assurance provider



Talent model

The core skillset of Internal Audit functions has remained relatively unchanged in the past decade, with the vast majority of functions telling us that financial controls (95%), general information technology (90%) and compliance (89%) skills form the bedrock of their departments.

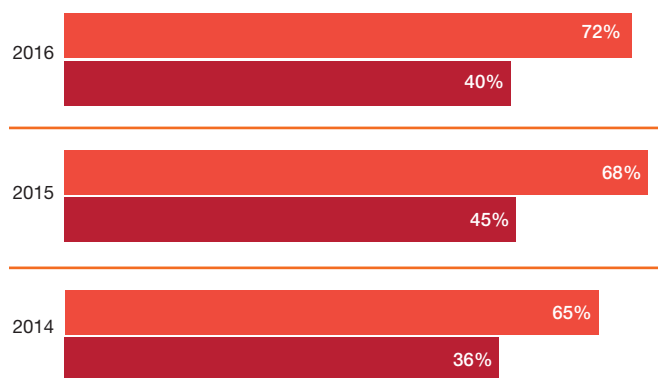
What good looks like

Internal Audit possesses the appropriate mix of core Internal Audit talent, subject matter expertise, business acumen and position parity to align to its mandate and meet expectations of stakeholders, including regulators. The talent model is flexible, balancing the need for specific industry and risk expertise against the likely utilisation of that expertise. The model includes the incorporation of regular training and performance feedback to enhance the department and facilitate growth and individual leadership development. Talent is managed to include the appropriate balance of technical skills and softer skills such as conflict management, intellectual curiosity, critical thinking, relationship development, and overall leadership.

Delivering maximum value Our point of view

Our State of the Profession (SOTP) study reveals that this attribute continues to receive low performance scores from stakeholders, even from those who view Internal Audit as a trusted advisor. This would suggest that the talent model within Internal Audit may not be keeping stride with the changing risk profile of the organisation it serves. On a more encouraging note, our SOTP study reinforces our view that high performing Internal Audit functions are characterised by strong, effective leadership and a talent model that supports the vision for Internal Audit and the wider strategy for the business. Meanwhile, risk profiles of companies beyond controls over financial reporting and general IT are increasing in complexity and stakeholders' demands for Internal Audit's involvement in these areas is increasing. Those Internal Audit functions that are proactively adapting their talent model to address this expanding risk profile are delivering greater value. This is not an easy undertaking. It requires a dynamic staffing model, which is complex to manage. It requires a conscious effort by management to promote Internal Audit as a progressive and exciting place to work in order to attract and retain leading talent. In these organisations, rotations in Internal Audit are valued and supported by the business leadership, beyond finance. Functions delivering the greatest value are strategic in their use of a co-sourcing partner and they know they have got it right because the business takes clear actions based on their recommendations. Stakeholders also seek out their talent to fill business leadership needs beyond financial reporting roles.

Figure 7: How Internal Audit is performing
% of companies where Internal Audit is performing well at talent model



Source: PwC State of the Internal Audit Study, 2014-2016

Trusted advisor
Assurance provider

6

Quality and Innovation



Internal Audit functions that aspire to be trusted advisors need to raise the bar by embedding innovation into the culture of their function.

What good looks like

Internal Audit promotes quality and innovation through well-defined standards that align to overall IIA standards (and any sector specific regulatory or domain standards). The function performs formal quality and promotes a culture that rewards innovation and continuous improvement of core processes. The audit plan aligns with the company's risk profile and changes as risks change. The form and message of Internal Audit reports and communications are based on facts, support the achievement of Internal Audit's mission and strategic objectives and influence stakeholders to take action. A function that consistently delivers a quality service and product is also focused on the strategic imperatives of the business. Data analytics, reporting and visualisation tools are consistently used to deliver on the core mandate and innovate.

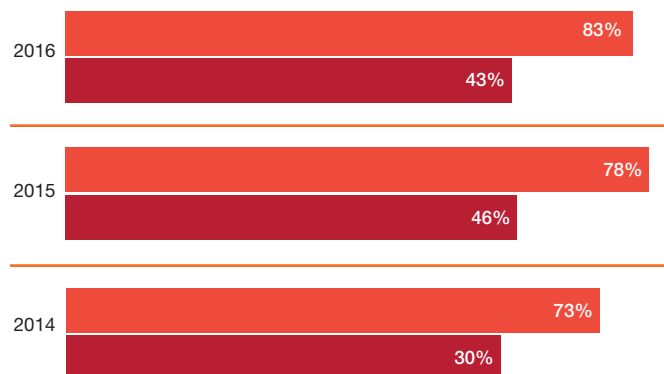
Delivering maximum value

Our point of view

Assurance providers take purposeful action to develop and maintain a quality programme that aligns to IIA standards. They consistently train the team in order to ensure proper oversight and to monitor quality on an ongoing basis. This can take a number of forms i) leveraging data visualisation tools to make wholesale changes to risk assessment and execution methodologies, ii) creating new reliance approaches across the other lines of defence or iii) re-inventing reporting techniques to enhance the stakeholder experience. Trusted advisors need to provide benchmarking and points of view on the maturity of business processes and capture audit findings visually in ways that enable them to better assess and communicate the business impact of a process/control breakdown. They consistently identify opportunities to innovate.

Figure 8: How Internal Audit is performing

% of companies where Internal Audit is performing well at quality and innovation



Source: PwC State of the Internal Audit Study, 2014-2016

■ Trusted advisor
■ Assurance provider



Technology

Leading Internal Audit functions are innovating their processes – investing in data analytics, technology and tools. Their objective is not simply to automate isolated audit procedures but, to transform their function in order to unlock real value across the entire Internal Audit life cycle.

What good looks like

Internal Audit leverages technology effectively in the execution of the entire lifecycle of the audit process. Robust audit management systems are either interfacing with or embedded into enterprise wide governance, risk and compliance (GRC) tools. Data analytics are designed and deployed enabling focus on the right risk areas and business issues, as well as generating efficiencies throughout the audit process. Analytics and visualisation tools are used to enhance the understanding and evaluation of risks and to identify business process and control breakdowns. Continuous auditing techniques are leveraged to increase coverage or provide early warning of risk indicators to the business. To deliver on this attribute, the Internal Audit team must understand the complexities of their company's systems architecture and innovate by using technology to drive audit efficiency.

Delivering maximum value

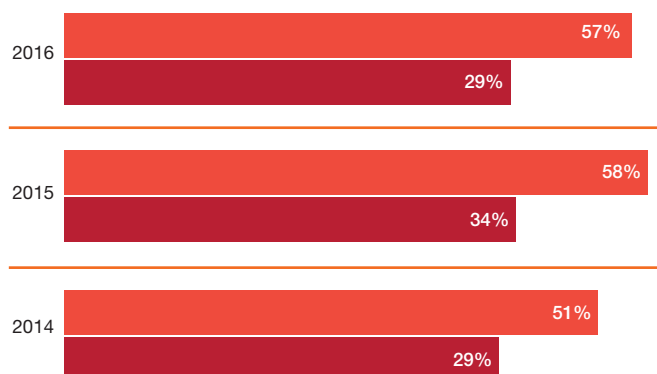
Our point of view

Our SOTP research shows that Internal Audit functions have improved their performance in the use of technology year on year. Yet, despite this improvement, stakeholders rate performance in this attribute lowest among the eight. This could indicate Internal Audit is not innovating in line with technological advancements and stakeholders' expectations.

For years, Internal Audit has leveraged computer assisted audit techniques (CAATS) but the time has come to move on. Today, these techniques and associated tools are being outpaced by higher functioning technologies that enable Internal Audit to embed analytics and visualisation throughout the audit lifecycle. New data enabling tools are being integrated into audit methodology and sometimes embedded into the audit management system, but this path to enhancing the use of technology is not easy and even trusted advisors experience resistance along the way. By way of example, the first time Internal Audit evaluates a full population of data and pinpoints the risks and related control failures stakeholders are not generally enthusiastic.

However, as these roadblocks surface, Internal Audit leaders must have the courage of their convictions and work to influence stakeholders' perceptions. They need to demonstrate the value being delivered and successfully influence the first and second lines of defence. In this way they can begin leveraging data themselves to enhance the overall control environment and protect the company from controls breakdowns.

Figure 9: How Internal Audit is performing
% of companies where Internal Audit is performing well at technology



Source: PwC State of the Internal Audit Study, 2014-2016

■ Trusted advisor
■ Assurance provider

8

Service culture



The best Internal Audit functions are more service culture orientated, anticipating stakeholder needs and providing a point of view beyond today's risks and controls.

What good looks like

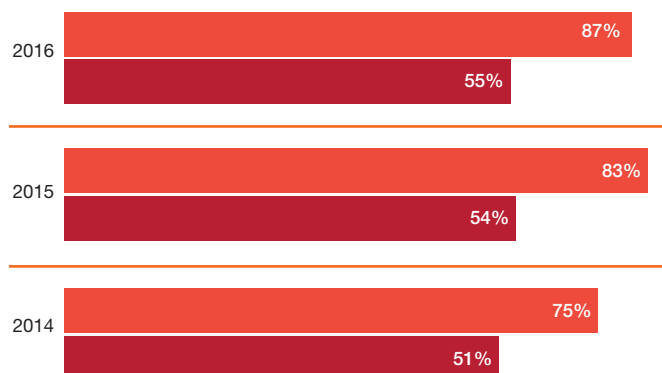
Internal Audit serves its many stakeholders, while maintaining objectivity, by having a well-defined mandate (mission, vision and scope) and clear reporting lines. The Internal Audit team and the organisation can succinctly articulate Internal Audit's mandate and brand. A client service plan is in place that drives purposeful engagement with the business, anticipates needs, drives timeliness and responsiveness, and focuses on bringing valuable insight to inform business decisions. Regular feedback is solicited from stakeholders, and the department measures results and develops improvement actions as needed.

Delivering maximum value

Our point of view

Internal Audit needs to change the way it communicates with management to be more engaging, accessible and relevant. The current approach adopted by many is focused on imparting information about planned audits, scope and objectives but it can feel to stakeholders a bit like being on the receiving end of a 'reprimanding'. The best functions are more service culture oriented and go beyond this anticipating stakeholder needs, exhibiting broad business awareness and with an unrelenting focus on getting to the root cause of issues. Internal Audit functions delivering at this higher level will have a 'seat at the top table' and be active contributors in executive sessions and board meetings on matters beyond their immediate mandate. This is because they have proactively positioned and educated themselves to have a point of view beyond today's risks and controls.

Figure 10: How Internal Audit is performing
% of companies where Internal Audit is performing well at service culture



Source: PwC State of the Internal Audit Study, 2014-2016

■ Trusted advisor
■ Assurance provider



Internal Audit. Expect More.

Through our research, we have gained tremendous insight on collective stakeholder expectations. We know that the expectations of each individual organisation's stakeholders vary dramatically. However, consistent themes have emerged around those Internal Audit functions perceived as delivering great value: they proactively set a vision for how Internal Audit can deliver, they have the courage to get stakeholders aligned and they possess the courage to stay the course for the good of the company – even during this time of significant change. And, while trusted advisors consistently receive higher performance ratings in our surveys than those performing at the assurance provider level, we encourage Internal Audit leaders to gain a deeper understanding of stakeholder expectations and performance along the eight attributes before they take action. For some functions, understanding stakeholder expectations and perceived performance may result in a need to enhance their stakeholder management program by raising brand awareness, educating stakeholders on mandate, and improving risk focus and current capabilities. Other functions may identify the need to align their risk focus to the business, invest in underlying audit processes, enable the function with better technology and enhance their overall talent model. Bypassing this important step may result in over or under investing in the journey ahead.

How PwC can help

As Heads of Internal Audit chart their course toward building functions which fully embrace the eight attributes of Internal Audit Excellence and capture unrealised value, so The PwC Internal Audit can play a key role in supporting them. Organisations may benefit from performing an External Quality Assessment leveraging PwC's proprietary Profiler tool or from a variety of our services.

To speak to one of our experts about how this may affect your business, contact:



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