

2018 NORTH AMERICAN PULSE OF INTERNAL AUDIT

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The Internal Audit Transformation Imperative



About the Pulse of Internal Audit

NUMBER OF RESPONSES

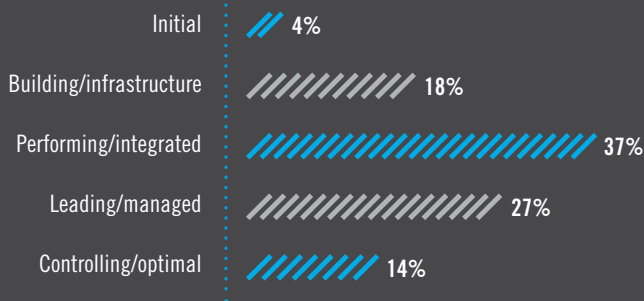
CAEs	552
Directors/senior managers	84
Total	636

The IIA's Audit Executive Center® (AEC®) has gathered insight from leaders in the profession through the annual Pulse of Internal Audit survey (Pulse) since 2009. Each survey collects information about both established and emerging issues that are important to the profession as well as information about internal audit management (such as areas of focus and staff levels).¹

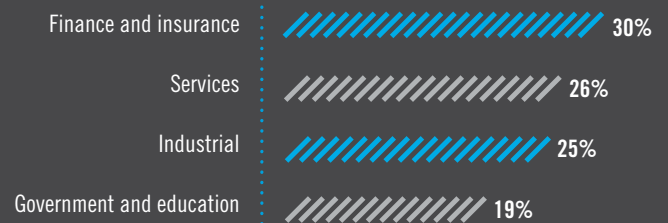
In Pulse reports, CAEs and directors/senior managers are collectively referred to as CAEs, and the terms audit department, audit function, and audit activity are used interchangeably.

The survey results are analyzed and presented in multiple reports of which this is one. Complimentary high-level reports are made available to the public through The IIA's Pulse of Internal Audit resource page (visit www.theiia.org/Pulse). More in-depth reports for internal audit management are available exclusively to members of the AEC. For more information about joining the AEC, visit www.theiia.org/AEC.

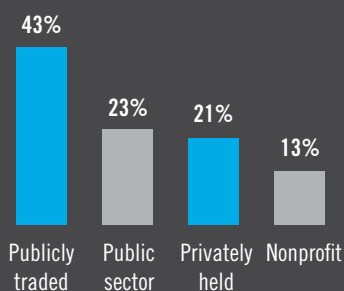
Internal Audit Maturity (Self-assessed)



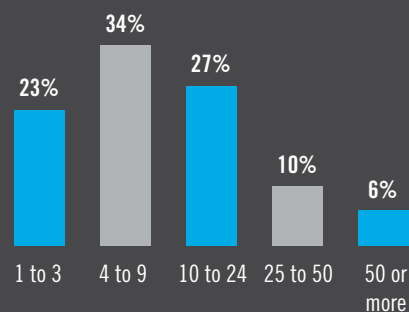
Industry Groupings*



Organization Type



Internal Audit Function Size (FTEs)



*Industry groupings were defined as follows: Industrial — manufacturing; construction; utilities; mining, quarrying, and oil and gas extraction; transportation and warehousing; waste management/remediation services. Services — health care; retail trade; real estate; accommodation and food; wholesale trade; entertainment; information; professional; agriculture. Government and education — public administration and educational services. Finance and insurance — financial institutions, insurance, asset management, broker-dealers.

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ABOUT THE AUDIT EXECUTIVE CENTER

The IIA's Audit Executive Center® is the essential resource to empower CAEs to be more successful. The Center's suite of information, products, and services enables CAEs to respond to the unique challenges and emerging risks of the profession. For more information on the Center, visit www.theiia.org/AEC.

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Introduction

Albert Einstein said, “*The world as we have created it is a process of our thinking. It cannot be changed without changing our thinking.*”

These words ring true for the profession of internal auditing. Change has always been, and will continue to be, a force that must be faced, as without it, progress is impossible. We live in a constantly evolving world, absorbing complete changes in ideas, convictions, business models, technology, and geopolitical landscapes, as well as changes that are — or at least look like — disruptions. And the only way to successfully navigate the changes and manage the disruptions is by changing our thinking and becoming agile.

In today’s world, disruptions are bigger, coming faster, and require responses that are quicker and more fluid. In this environment, internal audit is vulnerable — vulnerable to complacency, vulnerable to insignificance, vulnerable to being replaced. Transformation of internal audit is the only acceptable solution. CAEs need to lead the response to disruption with innovative strategies and an agile approach supported by the right talent. The tendency for some CAEs might be to wait for others to act first. This is a recipe for irrelevance. CAEs need to position internal audit to be an internal disruptor, relentlessly challenging the status quo, identifying and focusing on emerging risks. It is not the first time internal audit has needed to transform itself, and it likely will not be the last. But vulnerability, driven by disruption, requires transformation *now*.

Stakeholders continue to invest in internal audit. Staffing shows continued, steady increases and the CAE’s strong reporting lines position internal audit to continue to serve the organization well. However, there is no room for CAEs to take these indicators as validation that there is an unassailable level of satisfaction. While there have been many successes for internal auditing over the last 20 years, as the title from Marshall Goldsmith’s book puts it, *What Got You Here Won’t Get You There*.⁵

To be an internal disruptor, CAEs need to break out of their historical frame of reference and embrace agility and innovation. Pulse results show that less than half of CAEs consider their internal audit functions to be very or extremely agile; innovation is not a consistent activity throughout the internal audit profession; there are challenges in obtaining the right talent to support agility and innovation; and stakeholder engagement could be improved.

Internal audit must transform itself to provide value to organizations in the midst of disruption. This will require agility, innovation, talent, and engagement with the board, the four main focus areas of this year’s Pulse.

Disruption on the Horizon

- The NACD 2017-2018 Public Company Governance Survey lists significant industry change, business model disruption, and technology disruption as some of the most likely trends over the next year.²
- McKinsey reports that roughly one in three directors indicate their business models will be disrupted in the next five years.³
- The rapid speed of disruptive innovations and new technologies is the top-rated risk for 2018, according to a report from North Carolina State University ERM Initiative and Protiviti.⁴



Agility:

Embrace to Confront Disruption

Internal audit must quickly change direction when risks change. It is impossible to predict the future with certainty, but changes in risk should be expected. Internal audit has responded well, and with agility, to unexpected risks in the past. When the U.S. Sarbanes-Oxley Act of 2002 was enacted in response to financial reporting scandals, executives looked to CAEs and internal audit to help them understand, assess, and respond. When a financial crisis occurred less than a decade ago, many internal audit functions shifted their focus to those areas that would provide immediate short-term benefit to their organizations. However, there are many other examples where internal audit has not been agile — information technology (particularly cybersecurity), culture, and sustainability. These examples, among others, demonstrate a slow, often measured response. There are many experts competing for time on limited board agendas (compliance, risk, legal, and external audit, to name a few) and being less than agile can relegate internal audit to a supporting, maybe even irrelevant, role.

Internal audit agility was described well in the Risk in Focus: Hot Topics for Internal Audit 2018 report issued by the European Institutes of Internal Auditors: “Agile focuses on continuous improvement, scope flexibility, team input, and delivering essential products, whether applied to software development or audits. This involves close collaboration across audits and function members, auditee collaboration (whilst maintaining independence), and responding to changing requirements during audits and the delivery of audit plans.”⁶

Internal auditors focus on risk and the management of risk by their organizations. As such, internal audit needs to not only assess the nature and severity of potential future risks, it also must be prepared to handle the unexpected. Planning ahead is not sufficient. Internal audit must be agile enough to handle whatever disruptions come its way.

Pulse indicates that while two-thirds of CAEs see agility as very or extremely important in the future,⁷ only 45 percent currently consider their internal audit departments to be very or extremely agile.⁸ Even more telling is that most CAEs say their stakeholders see agility of internal audit as primarily being something expressed in the medium or long term, which by definition is not agility.⁹

CAEs can see the disruption affecting their organizations today and can reasonably forecast there will be further disruption in the future. They need to be nimble enough to pivot, to refocus, and to reposition internally as needed. The path to agile internal auditing has a number of important elements — mindset, the right focus, flexible processes, the right talent, and proper positioning.¹⁰



of **CAEs** consider their internal audit functions to be **very or extremely agile**.

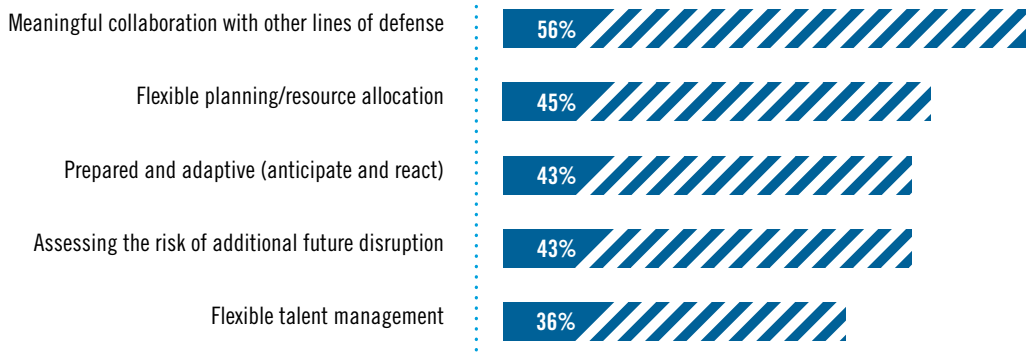


The Path Forward: Agility

Pulse survey results reveal a gap between what CAEs consider as important and what they are doing about it when it comes to agility. Two-thirds see agility as highly important, while less than half see their departments as highly agile. To confront disruption and stay relevant, internal audit must start down the path to agility *now*.

1. **Start with a change in mindset.** The CAE needs a change in mindset to lead internal audit toward being agile, and internal auditors need a change in mindset to implement agile internal auditing. This change in mindset includes refocusing processes, rethinking resources, and repositioning. Being agile is not simply implementing a new process, performing certain tasks, or initiating activities patterned after a buzzword-laden promise from the latest business guru. CAEs must recognize the right mindset as a foundational aspect of agility.
2. **Prepare to quickly refocus on disruptive risks and opportunities.** Only 43 percent of CAEs state their internal audit functions are fully or partially prepared to anticipate and react to disruption (Exhibit 1). This is likely the result of a focus on the past or a reluctance to quickly change internal audit plans.
 - Risk identification and assessment needs to be fluid, timely, and forward-focused. History is important as one learns from the past. However, that learning should not define internal audit's views, but inform them. Internal audit's focus must be on future risks and opportunities, what it has not seen before, what is present but obscured, and what it might have seen before but is now changed. Risk identification and assessment is continual, as disruptive events do not always provide much advance notice.
 - Internal audit needs to be fluid in its planning and activities so that rigidity does not impede agility. However, only 45 percent of CAEs say they have strategies in place involving flexible planning and resource allocation (Exhibit 1). The only thing certain about an annual or quarterly audit plan, or even the audit plan for a specific audit, is that it will likely change before the work is completed. Audit plans should be viewed as a framework that will change as disruptive events occur. To be more fluid, CAEs should focus less on an immovable annual plan and instead expect to update plans frequently. In addition, CAEs should set the expectation with stakeholders that audit plans will change whenever needed. To better support agility, internal audit should take a "modular" approach by creating high-level plans for more audits than can be performed. Engagements can be planned in greater detail or initiated in response to disruptive events.

Exhibit 1: Disruption Responses Implemented by Internal Audit



Note: Q26: For each of the following potential approaches your audit team could use in responding to your organization's disruption, please indicate the degree to which your internal audit department has implemented each of the following: Percentages show respondents who indicated full or partial implementation. *n* = 495.

3. **Prioritize work according to what matters most.** Auditors can audit anything, but they should not audit everything. It is important that time is spent on the things that matter most (highest risk and biggest impact, among others). CAEs also should challenge the traditional way of getting things done and explore new technologies and audit approaches, while still being disciplined, systematic, accurate, and timely. Common practices that impede internal audit's agility, or the ability to pivot quickly, include focusing on areas of low risk, lengthy and unnecessary documentation, documenting work long after it is done, and reporting too much information to too many parties.
4. **Break the mold and create teams with the right blend of skills.** CAEs cannot fully anticipate what risks are going to manifest next. Well-rounded, flexible resources that bring a variety of competencies are best able to respond to disruption. Yet, CAEs still predominantly look for candidates with accounting and finance degrees (rated extremely or very desirable by 76 percent of CAEs).¹¹ At the same time, CAEs say the top three skills they are recruiting for are analytical/critical thinking, communication, and business acumen.¹² Only 36 percent of Pulse respondents have implemented flexible talent management strategies as a way to respond to disruption (Exhibit 1).
5. **Coordinate with other resources in the organization.** Internal audit is not separate from the organization and should not operate as an island. The need for independence and objectivity does not require isolation. When CAEs were asked about potential strategies to address disruption, collaborating with other lines of defense was the most common approach taken, but only by slightly more than half (56 percent) (Exhibit 1). CAEs may need to explore this option more fully.

CAEs are likely to encounter several roadblocks on the path toward agility. The top three roadblocks identified by CAEs relate to resources, organizational complexity, and executive management's expectations (Exhibit 2). Inadequate quantity of resources is the most frequently cited roadblock, especially by CAEs with smaller audit functions. While not dismissing the advantages of having more resources, agility is more driven by a state of mind than resources. And to be realistic, internal audit will never get all the resources it could deploy. The CAE's approach should not be to hope for more resources and explain internal audit's lack of agility on failing to get those resources. The CAE's approach should be to use the existing resources more effectively, and justify additional resources with internal audit's proven ability to be effective and agile.

Of particular interest is the notable percentage of CAEs (38 percent) who responded that overly traditional expectations of executive management are a roadblock to agility (Exhibit 2). Those CAEs who experience this roadblock need to address it with members of management, explaining the value of internal audit's efforts to refocus, align resources, and reposition to help the organization respond to disruption.

Exhibit 2: Factors Perceived by CAEs as Roadblocks to Internal Audit Agility





Innovation:

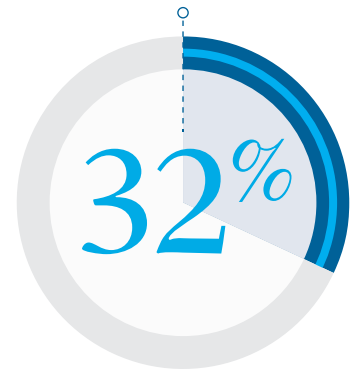
Pursue Quantum Leaps

Disruption presents two options for internal audit: envision the function's capabilities to fill an increasingly important role in an organization or presume past practices will carry it into the future. Relying on past practices is a near guarantee of future failure. What internal audit needs now are quantum leaps in innovation. This type of innovation is a relentless, fundamental challenging of what is done, how it is done, and how well objectives are being accomplished. The mindset needed is not one of merely improving the status quo, but of redefining "acceptable" and transforming internal audit.

The *International Standards for the Professional Practice of Internal Auditing* require internal auditors to have a quality assessment and improvement program in place. Many CAEs are pursuing continuous improvement related to existing processes, including gathering audit evidence, communicating results, and collaborating with others within their organizations — but that is not enough. CAEs also must challenge themselves and their teams to design and implement new ideas, making innovation a core foundation to their practice of internal auditing. Not only does innovation lead to better and more efficient auditing, but innovation directly supports agility when it enables a faster, smarter, and more focused response to disruption.

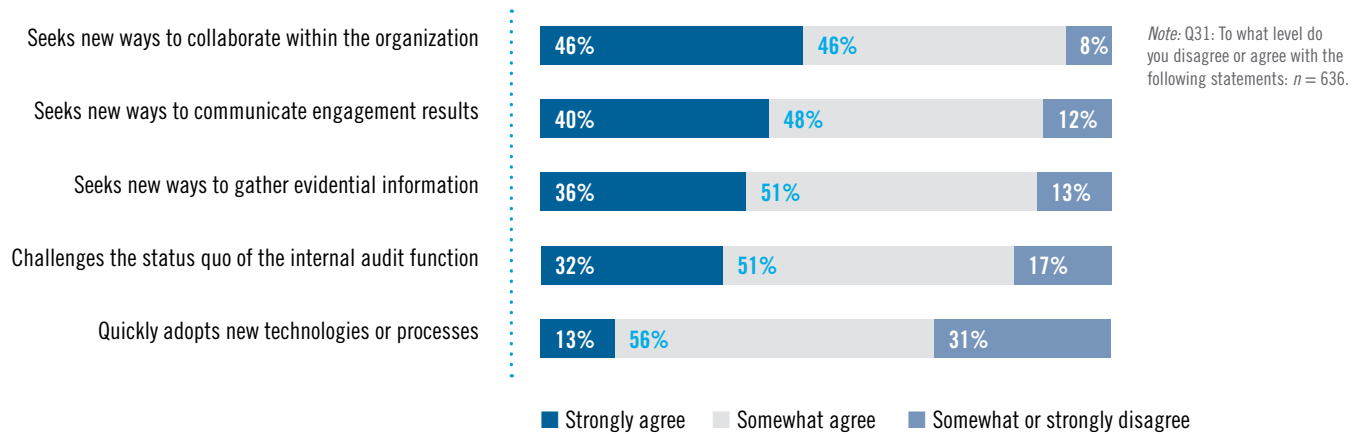
While innovation requires CAEs to challenge themselves, only a third of CAEs strongly agree that their internal audit functions challenge their own status quos (Exhibit 3). The Pulse also reveals that those who challenge the status quo also evaluate themselves as the most agile.¹³ Critically challenging oneself and not letting a "this is how we do things around here" attitude get in the way will lead to greater innovation and agility.

There are challenges associated with being at the forefront of innovation, such as missteps, wasted effort, and failing to meet promises. However, innovation can take many forms. The internal audit profession does not need to outdo Apple, Tesla, and Amazon as innovators to bring value. According to Shannon Urban, 2017-2018 chairman of The IIA's North American Board, "Innovation in internal auditing is both crucial for its growth and necessary in meeting the ever-changing needs of stakeholders. It is a messy, frustrating, and ongoing program that demands commitment and courage. And it is fun, surprising, and rewarding. All auditors can take a few easy steps to start, or reboot, their journey today. If we want to understand our stakeholders and serve them well in the future, embracing innovation is the only option."¹⁴



of CAEs strongly agree their internal audit functions challenge their own status quos.

Exhibit 3: Innovation Activities in the Internal Audit Function



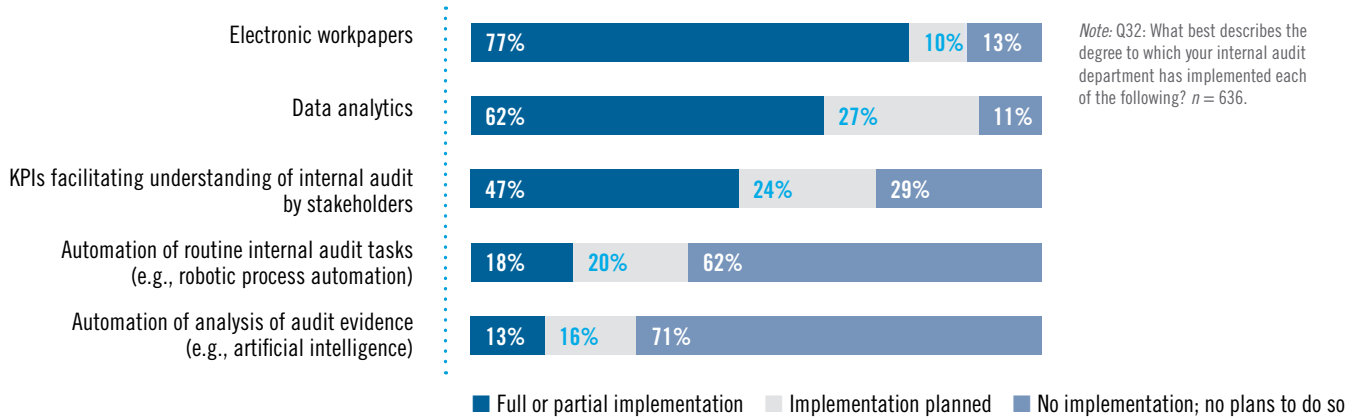
The Path Forward: Innovation

Ninety-one percent of CAEs report they are a key driver of innovation in their internal audit functions, while 62 percent report that staff also is a key driver. Only about one-third of CAEs mention executive management and/or the audit committee as key drivers of internal audit innovation.¹⁵ Both CAEs and their staffs should pursue steps toward more innovation.

- 1. Recognize the need for self-assessment and challenge how objectives are being accomplished.** Most internal auditors understand the need to spend time planning before starting an audit. Similarly, internal auditors need to devote time and effort to challenge themselves and search for opportunities to innovate. This includes giving staff time for self-assessment and opportunities to challenge the status quo.
- 2. Embrace technological advances.** Technology is the area of potential innovation that was the least implemented by Pulse respondents.
 - Only 13 percent of CAEs strongly agree their internal audit functions are quick to adopt new technologies or processes (Exhibit 3).
 - Electronic workpapers and data analytics have strong rates of implementation (Exhibit 4), but these technology-enabled advances have been available for decades. They are no longer considered innovative.
 - There has been very little adoption of automated routine audit tasks (e.g., robotic process automation) or automated analysis of audit evidence (a type of artificial intelligence) (Exhibit 4). These are difficult technologies to master, especially as they are not mature. However, most CAEs report they have not implemented, and have no plans to implement, these technologies. A mindset of innovation requires embracing technology in planning the future, not avoiding it.

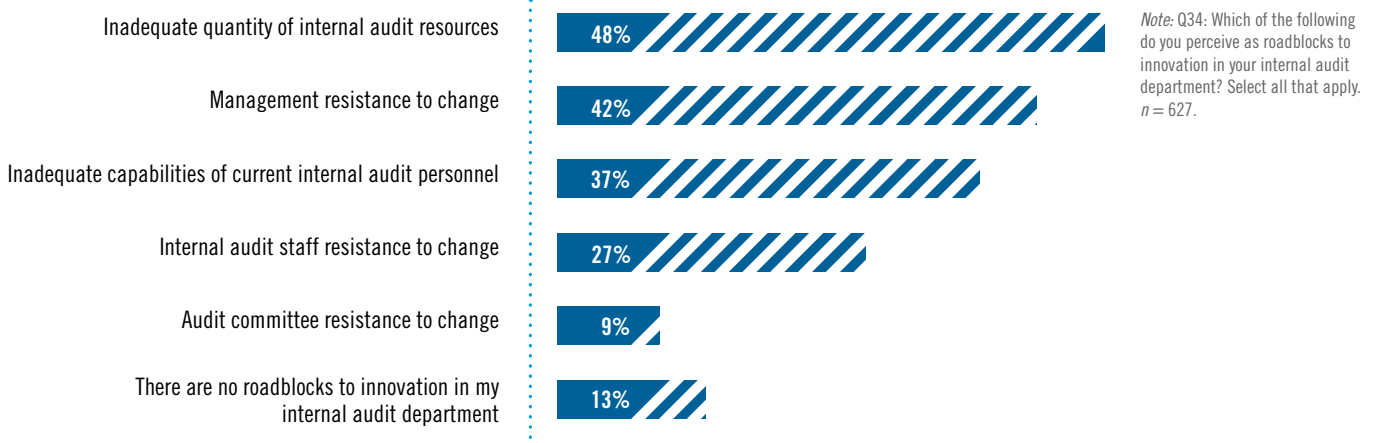
Technology can be leveraged to free up time and enable more fluid and flexible activities. This requires planning and continual evaluation to balance moving too fast and misfiring versus moving too slow and becoming inefficient or potentially irrelevant. From Pulse, it is clear that internal audit's adoption of technology is closely associated with internal audit's maturity. Interestingly, there is no association between innovation and the size of internal audit. Exploring and adopting technology is something more mature internal audit functions pursue, but it is well within the reach of smaller internal audit functions.

Exhibit 4: Internal Audit Implementation of Innovation



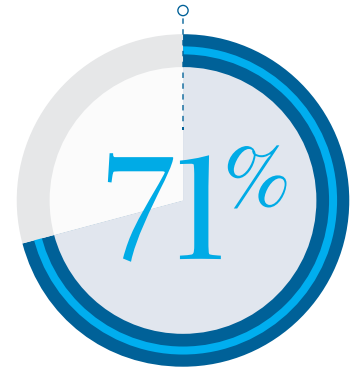
3. **Do not blame the failure to innovate on the lack of resources.** CAEs identify several roadblocks to pursuing innovation (Exhibit 5). Nearly half of respondents (48 percent) indicate that an inadequate quantity of internal audit resources is a roadblock to innovation, followed by management resistance to change (42 percent), and inadequate capabilities of current internal audit personnel (37 percent). Obtaining more resources, or different resources, requires agreement of the audit committee and usually the support of management. As only 9 percent of CAEs indicate the audit committee is a roadblock to innovation, CAEs should focus on obtaining the support of management. However, CAEs should not consider more resources as the primary solution to a lack of innovation. Like agility, innovation requires a mindset change even more than resources. It only takes a few of the right people to produce a tremendous amount of innovation.

Exhibit 5: Roadblocks to Internal Audit Innovation



4. **Develop and communicate the case for internal audit to actively pursue innovation.** Innovation requires investment in time and attention with the return on this investment through improved effectiveness and efficiency — and of course agility. CAEs must think carefully about innovation and develop specific proposals. Seek out, and prepare to have difficult discussions with, executive management to explain why changes in audit approach and resource management are necessary, keeping the audit committee informed. While a CAE could take advantage of an audit committee’s positive influence on management, this should be a secondary avenue. CAEs should primarily gain management’s support through a well-thought-out strategy.

Some CAEs may be reluctant to actively pursue innovation, preferring to sit back and wait, instead of being a leader, or even a fast follower. This is a formula for ineffectiveness and irrelevancy. Pursuing innovation is necessary to improve and better address risks facing the organization, even though innovation will invariably introduce new risks to the achievement of internal audit’s objectives. There will be remarkable successes as well as definitive failures. CAEs should be realistic — successful pursuit of innovation requires a vision, time, effort, and the willingness to replace simple but suboptimal internal audit methods with more sophisticated, effective methods. Great progress is not accomplished overnight, and missteps will occur.



.....
of **CAEs** perceive
moderate to **extensive**
residual risk from
data analytics use in
their organizations.
.....



Special Risk Insight: The Organization's Use of Data Analytics

Internal audit is not the only function driving for agility and innovation.

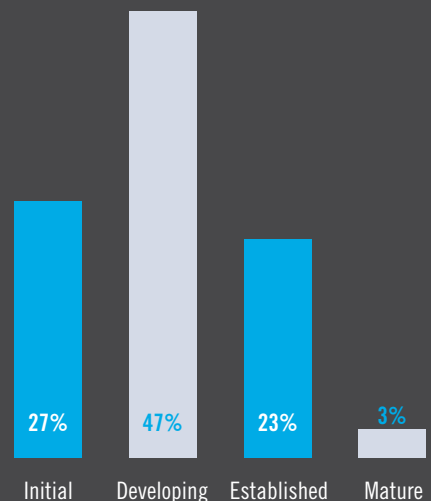
Many, if not most, functions within an organization also are likely looking to innovation in response to disruption and increasing pressures on success. In many cases, innovation involves the use of data analytics — tapping into the massive amounts of data available within the organization and the improved technology for analyzing and making decisions based on that data. Similar to internal audit, advancements in data analytics are pursued in different organizations at different speeds. Most CAEs report their organization's maturity level for data analytics as less than established (Exhibit 6). These responses are similar across all industries, type of organization, or size.

Sophisticated data analytic techniques such as robotic process automation and predictive analysis are used less frequently by organizations, compared to simpler, more established techniques such as trend and correlation analyses. However, fewer than one-third of CAEs report that their organizations extensively use even the simplest data analytics techniques (Exhibit 7).

CAEs recognize and must consider the organization's data analytics-related risks. Most (71 percent) CAEs indicate that their organization's residual data analytics risks are moderate to extensive.¹⁶ Topping the list is the risk that the organization will not be able to meet changing needs and requirements concerning data analytics.

Data analytics should foster innovations to improve decision-making, enabling the organization to be more agile in the face of disruption. Most organizations' data analytics efforts are reportedly too immature to deliver on this expected outcome.

Exhibit 6: Organizational Data Analytics Maturity



Note: Q21: How would you rate the average level of maturity of your organization's data analytics efforts (not internal audit, but your entire organization)? *n* = 633.

Exhibit 7: Organizational Use of Data Analytics Techniques

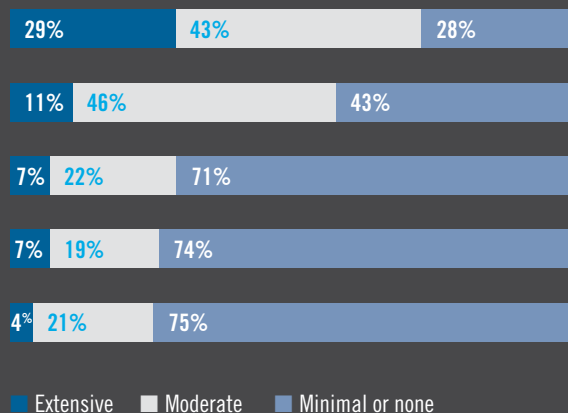
Simple techniques such as ratio, trend, and correlation analyses

Identification of unusual transactions, balances, or data relationships data

Automation of routine tasks (e.g., robotic process automation)

Sophisticated techniques such as regression, complex pattern recognition, and predictive analyses

Automation of data analysis resulting in scripted decision-making (e.g., artificial intelligence)



Note: Q22: Please indicate the degree to which your organization uses any of the following methods and application of data analytics. *n* = 620.

■ Extensive ■ Moderate ■ Minimal or none



Talent:

Focus on Tomorrow's Risks

CAEs can have all the right intentions and work diligently to increase internal audit's agility and innovation, but without the right talent these efforts cannot succeed. A CAE needs to have sufficient people with the right competencies on hand to swiftly and decisively respond to new or emerging risks. Most CAEs (72 percent) say they have gaps to fill.¹⁷

Finding and attracting enough candidates with the right skills continues to be a challenge for many CAEs. More than 90 percent of CAEs report difficulty in recruiting experienced personnel, and 60 percent express difficulty recruiting entry-level staff.¹⁸ Getting any talent, but especially experienced talent, is difficult.

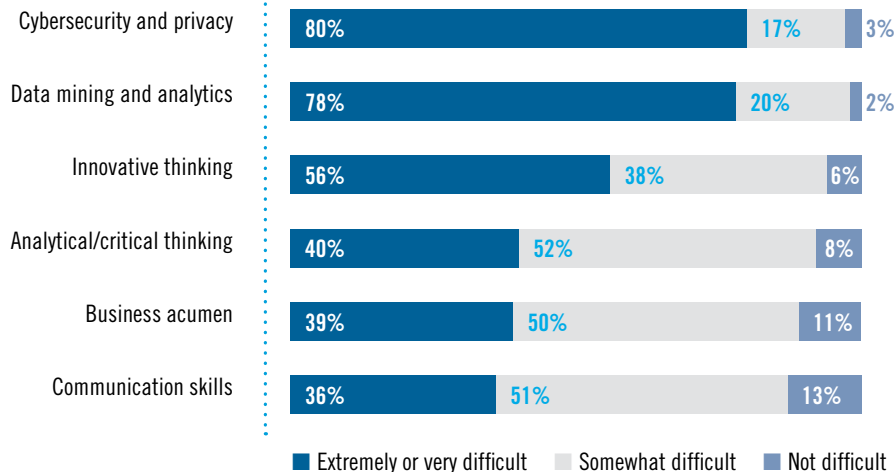
CAEs have identified analytical/critical thinking, communication, and business acumen as the three top skills they focus on when recruiting.¹⁹ Given the disruption organizations are experiencing, and the need for internal audit to become more agile and innovative, these skills are well aligned with what it will take to be successful. However, it is not easy to find staff with these skills. Many CAEs report it is extremely or very difficult to recruit each of these skills, and even more report at least some difficulty (Exhibit 8).

Other specific skills that could support responding to disruption and encouraging innovation also are difficult to recruit and hire. More than three-fourths of CAEs report it is extremely or very difficult to recruit personnel with cybersecurity and privacy/data mining and analytics skills (Exhibit 8). Not coincidentally, CAEs have the least confidence that their internal audit functions have sufficient collective competencies in these areas (Exhibit G in the Appendix). In addition, more than half



Regarding adequate competent, objective professionals to carry out the audit plan, **72% of CAEs say they have gaps to fill.**

Exhibit 8: Internal Audit Competency Recruiting Difficulty



Note: Q15: Please indicate the degree to which you have difficulty recruiting individuals with the following competencies. *n* = 563.

of CAEs report it is extremely or very difficult to find personnel with innovative thinking skills, which could be critical to changing the collective mindset of the internal audit function.

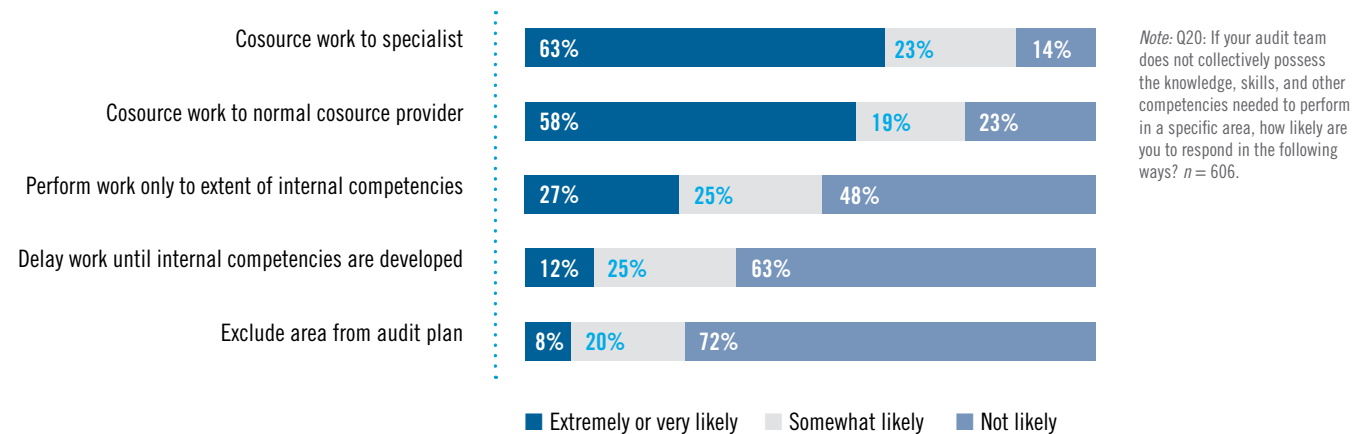
While the job market may make it difficult to find sought-after skills, CAEs are often too limited in where they are looking. CAEs need to broaden their perspective of where they can find talent.

The Path Forward: Talent

According to Pulse respondents, the top three barriers to obtaining the right talent are a lack of qualified candidates, salary limitations, and budget restrictions.²⁰ Following the well-worn path CAEs have traditionally used to acquire talent will be unlikely to solve these issues. CAEs need to consider alternative approaches to filling internal audit talent gaps.

1. **Make sure the risks that drive internal audit's scope drive staff competencies and not the reverse.** The reality for most CAEs is they do not have the quantity and/or quality of personnel they believe they need. The most common solution to fill this talent gap is to use a cosourced provider (Exhibit 9). However, many CAEs use other approaches that all involve scope limitations to avoid audit work that requires skills internal audit does not have. Half of CAEs report it is likely they would limit work only to where they have competencies; and more than one-quarter would delay work, or exclude risk areas entirely from the audit plan, when they do not have the required competencies. While internal auditors should not perform work for which they are not competent, altering scope to avoid risk areas cannot be a long-term strategy.

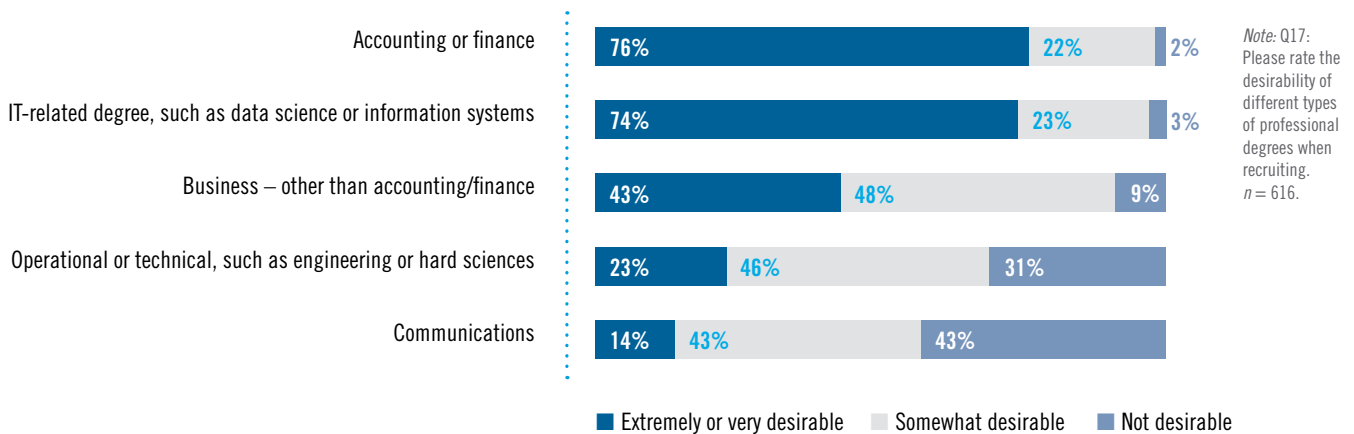
Exhibit 9: Responses to Gaps in Competencies on the Internal Audit Team



2. **Develop a talent strategy to ensure the right pipeline of qualified personnel.** Such a strategy looks at the skills and level of resources needed, and sets out a plan to make sure they are available. Limitations to scope should not be part of the strategy, reserved for only those rare occasions when talent plans derail for some reason. Alternatively, use of cosourcing resources can be a valid part of a well-planned talent strategy.

- Engage stakeholders and obtain their support for internal audit's talent management strategy.** Such a strategy needs to be communicated and approved by executive management and the audit committee.
- Start looking for candidates with different backgrounds.** The most recruited academic degrees are accounting or finance, followed by IT.²¹ Less than one-quarter of CAEs consider operational or technical degrees as extremely or very desirable (Exhibit 10). When looking for analytical/critical thinking, communication, and business acumen competencies, there is no reason to believe candidates with accounting or finance and IT degrees have any substantive advantage over operational and technical backgrounds.

Exhibit 10: Most Recruited Academic Degrees

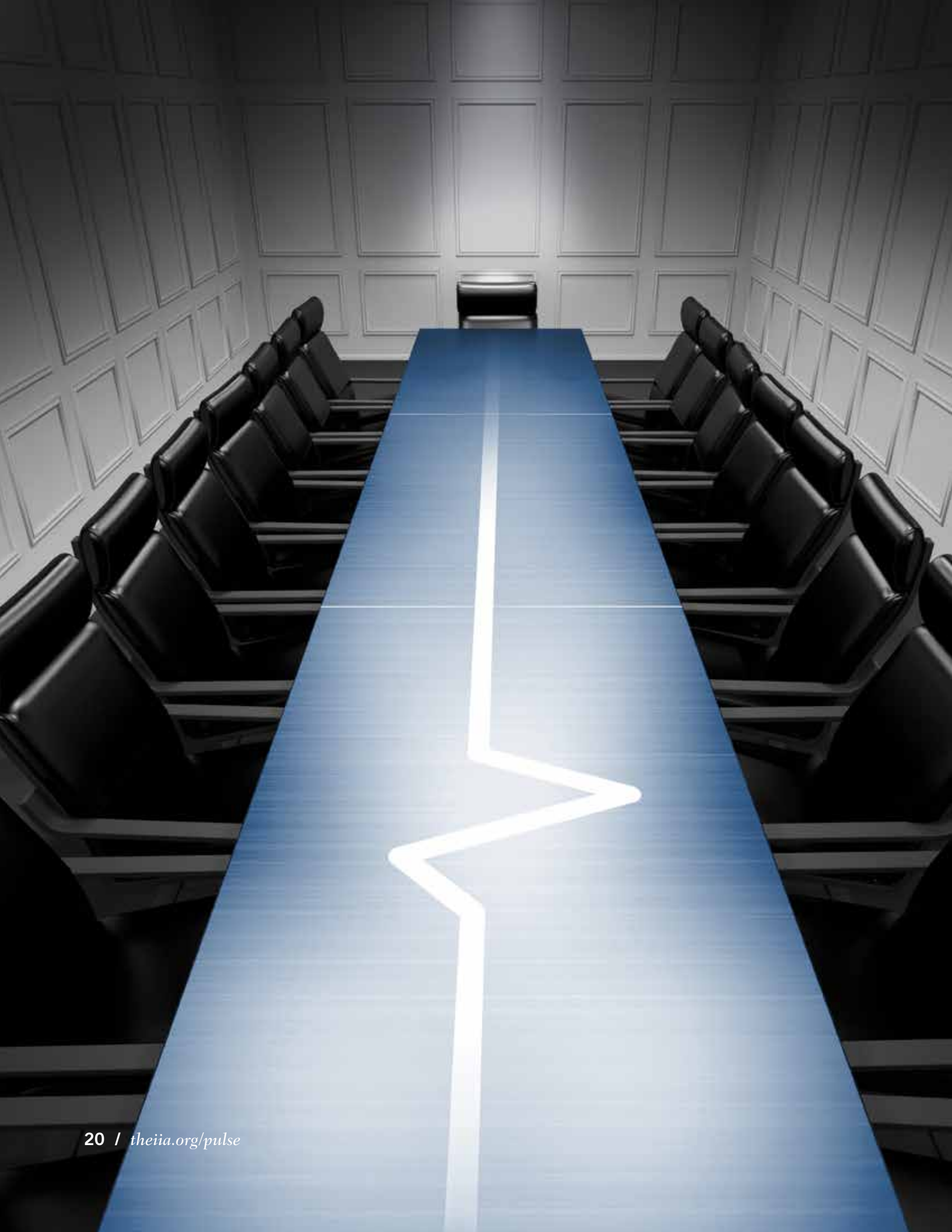


- Reconsider which skills are most essential for success.** CAEs evaluate most skills used in internal auditing as very or most essential.

Half of CAEs say data mining/analytics and cybersecurity are only somewhat or not essential skills.²² At the same time, CAEs rate these two skill areas the lowest when evaluating the collective competency of their internal audit functions.²³ While these skills are difficult to find, this does not make them less critical. Data analytics can be used as a key enabler for innovation, and cybersecurity is a top risk area. CAEs need to reconsider the importance of these skills within their functions.

- Include future-focused training and development programs geared toward specific levels of staff.** CAEs will not be able to hire their way out of this skills shortage. Innovative thinking, communication, technology, and other skills that support innovation and agility are in short supply. CAEs need to focus on building these skills among existing staff.

Professional development and nonconventional training opportunities, including one-on-one coaching, team coaching, and self-directed or high-impact learning opportunities, wield influence when attempting to recruit and retain employees. A supportive culture for professional development is critical, and CAEs that develop talent continuously and consistently can identify gaps, strengths, and weaknesses in the internal audit activity. Professional development plans with specific annual targets and provisions for training help to ensure a high level of collective proficiency for the internal audit activity. Employees will make the most of employer-provided training and professional development programs, as they consider growth in an organization and how they can further their skills. Internal audit functions that make provisions for these and other types of career development programs help themselves with talent recruitment, development, and retention.



Board:

Move From Oversight to Engagement

Internal audit is dedicated to the organization's success. Organizations have multiple stakeholders, and internal audit engages with many of them in pursuing its role. With advances in technology and recent governance failures, stakeholder expectations of internal audit are changing quickly and have never been higher. CAEs must constantly align with organization needs and stakeholder expectations. If internal audit ever becomes complacent and solely focuses on delivery, it will quickly find itself drifting into irrelevance.

All organizations have some form of oversight by owners or stakeholders. Ninety-four percent of CAEs report their organizations have audit committees, or similar types of groups, that oversee internal audit activities. This is universal among publicly traded and nonprofit organizations (100 percent), and it is common for privately held (90 percent) and public sector (82 percent).²⁴ This oversight structure helps ensure internal audit stays aligned with the needs of the organization.

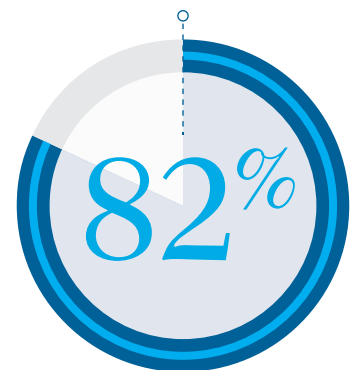
Oversight of internal audit includes consideration of internal audit's focus, plans, conclusions, resources, and interactions with management. Internal audit's point of view might not always align with management. The best practice is for CAEs to have their own relationship with audit committee members, separate from management. The vast majority of CAEs have the opportunity to build these relationships. Ninety percent of CAEs report they attend all of their audit committee meetings,²⁵ and 82 percent have unfiltered access to their audit committee at all times.²⁶ These opportunities are somewhat more common for more mature internal audit functions, but responses do not differ significantly based on the size of the internal audit function.

Audit committees also strongly support internal audit functions in some areas (Exhibit 11). Approximately two-thirds or more of CAEs strongly agree that:

- The CAE engages in an open, transparent relationship with the audit committee.
- Internal audit is empowered to be independent by its reporting relationship to executive management and the audit committee.
- The audit committee reviews and approves the internal audit charter annually.
- The audit committee chair meets periodically with the CAE without the presence of management.
- The internal audit plan incorporates input from the audit committee.

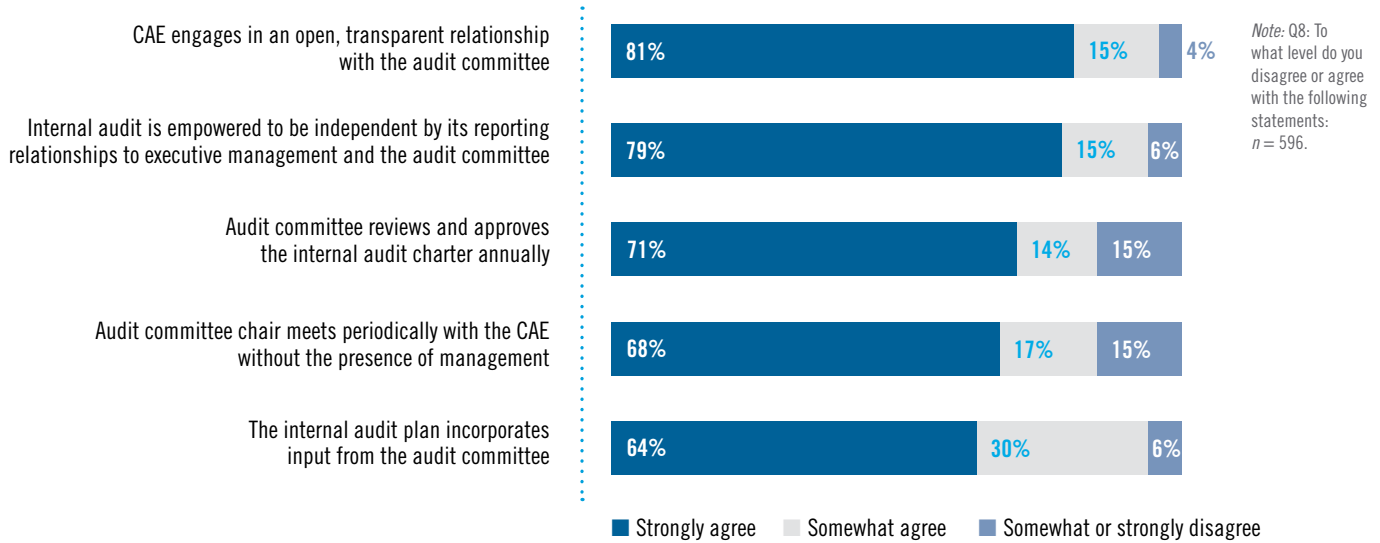


of audit committee meetings are attended by the CAE.



of CAEs have unfiltered access to their audit committees at all times.

Exhibit 11: Strongest Areas of Support by the Audit Committee



The Path Forward: Board Engagement

The audit committee relationship is critical for CAEs. But this relationship relies on more than reporting structures and meetings. Pulse results illuminate opportunities for CAEs to become more engaged and build stronger relationships with the audit committees.²⁷

- Increase the audit committee's involvement with internal audit's resources and performance.** Less than half (48 percent) of CAEs strongly agree that the audit committee reviews and approves resources of the internal audit activity. Only 38 percent strongly agree that the audit committee regularly communicates with the CAE about performance and improvement of internal audit. Apparently, meaningful oversight of resources and performance is being left to management. Having audit committee members more involved in reviewing and approving resources, and providing direct feedback on performance, will enable them to better support the work of internal audit.
- Improve the audit committee's understanding of the risks the organization faces.** Only about half (53 percent) of CAEs strongly agree their audit committee has a clear understanding of the strengths and weaknesses of their organization's risk management and internal control systems. CAEs need to help audit committee members become more knowledgeable about risk management and internal control systems.

3. **Discuss with the audit committee those situations where the CAE disagrees with management.** Relationships with management can vary substantially over time and within organizations. At an extreme, some in management may even challenge the independence of internal audit or objectivity of internal auditors and the CAE. While nearly two-thirds (62 percent) of CAEs say their audit committee addresses objectivity/independence issues with the CAE, only 52 percent strongly agree the audit committee will forcefully support the CAE if there is a dispute with management, leaving considerable room for improvement.

CAEs should work to build awareness among audit committee members that the audit committee is the true driver and the true enabler of internal audit effectiveness. Audit committee members need to understand that their functional responsibility for internal audit allows internal audit to be independent and internal auditors to be objective.

Cultivating excellent relationships with audit committee members so they fully understand internal audit's views on risk and control, resources, and performance should help ensure the audit committee will not just "stand behind" internal audit when there is a dispute with management, but instead will "stand with" them. CAEs must recognize that it is important for management to be satisfied by internal audit's work, but it is more important for the board to be comfortable with, and confident in, the assurance and insights it receives from internal audit.

However, gaining and using the support of key stakeholders will never be sufficient for internal audit to be effective. Without the requisite agility, breakthrough innovation, and a fundamental reworking of talent, internal audit will not provide the value it must as organizations experience high levels of change and disruption.



strongly agree the audit committee will forcefully support the CAE if there is a dispute with management.





Conclusion

Internal audit is vulnerable as organizations press through multiple sources of disruption. CAEs have a decision to make. They can confront head-on the forces of disruption and propel internal audit forward, or sit back and degenerate into irrelevance. While the future is never fully predictable, one thing is clear — what has worked in the past will not work in the future. To position internal audit to bring value to organizations, CAEs need to:

- Embrace agility, adopting a new mindset and putting in place actions that may be uncomfortable. Reinvent how risk identification, planning, audit tools, and talent are used. Stop blaming sluggishness on lack of resources and recruit or develop necessary competencies. Agility can be embraced by unleashing the passion and ability of current resources to be more agile.
- Challenge themselves as to why internal audit is not known for innovation. Make full use of current technologies, not those from the last century, to transform insight into something that is delivered better and faster. Knock down the roadblocks to innovation by looking at it differently, getting the right support, and aligning the right resources.
- Acquire or develop talent for tomorrow's risks. Let risk drive which resources are sought, operating through a defined talent strategy. Stop relying on old habits in finding talent — new risks require new talents.
- Help boards mature beyond oversight to engagement. Internal audit can make tremendous contributions to organizations, but it needs the board engaged in what really matters. Inadequate attention from boards to internal audit budgets, performance, and conflict with management will diminish internal audit's contribution.

Internal audit's progress over the past, and the successes accomplished, will not be enough to carry the profession forward. Current times require changes in mindset and actions from all internal auditors. Complacency will lead to irrelevance, but decisive moves by CAEs will propel internal audit forward through the transformation required.

“There are risks and costs to a program of action. But they are far less than the long-range risks and costs of comfortable inaction.”²⁸

John F. Kennedy
U.S. President

A DAY IN THE LIFE OF A CAE...

It is Monday morning and a CAE is reviewing the week's agenda. The CAE's key tasks for the week include:

1. Interview a candidate for the position of data scientist within the internal audit function.
2. Prepare a report for the audit committee on internal audit's success in using robotic process automation identifying suspect financial transactions to ensure they were addressed by management.
3. Provide assurance over the reliability of the algorithms underlying the organization's artificial intelligence (AI) activities.
4. Meet with operations leaders to provide advice on how to establish AI metrics.
5. Meet with the training function to explore developing a program to help internal audit staff increase their collaboration and empathy.
6. Work with HR to develop an adaptive, flexible, innovative staffing model that addresses hiring difficulties.
7. Revise the audit plan to respond to a new geopolitical disruption that occurred the night before.

This is not the distant future for internal audit — it will be reality very soon. CAEs who are not preparing for these tasks are already lagging behind and vulnerable.

Appendix:

Internal Audit Management Metrics

CAEs need to have strong management skills — and the ability to efficiently use resources — to achieve the internal audit function’s objectives. Annually, The IIA collects information on key internal audit management metrics, as illustrated in this appendix. A more in-depth report on internal audit management will be available exclusively to members of the Audit Executive Center. For more information about joining the AEC, visit www.theiia.org/AEC.

Methodology

Internal audit management metrics are provided for five organization types: publicly traded, public sector, privately held, nonprofit, and financial services. Due to significant participation from, and the unique characteristics of, financial services organizations, financial services was created by extracting financial services respondents from the other four organization types.

The distribution of respondents by organization type, and the top industries for each organization type, are:²⁹

Publicly Traded – Excluding Financial Services (31%)

- Manufacturing (31%)
- Mining, quarrying, and oil and gas extraction (12%)
- Utilities (8%)
- Information (6%)
- Health care and social assistance (5%)

Privately Held – Excluding Financial Services (9%)

- Manufacturing (28%)
- Professional, scientific, and technical services (13%)
- Other services (7%)
- Health care and social assistance (7%)
- Retail trade (7%)

Public Sector – Excluding Financial Services (21%)

- Public administration (41%)
- Educational services (31%)
- Utilities (8%)

Nonprofit – Excluding Financial Services (9%)

- Health care and social assistance (54%)
- Educational services (22%)
- Other services (9%)

Financial Services (30%)

- Financial institution (54%)
- Insurance (27%)
- Asset management (7%)
- Broker-Dealer (3%)
- Other (9%)

Reporting Lines

Exhibit A: Administrative Reporting Lines

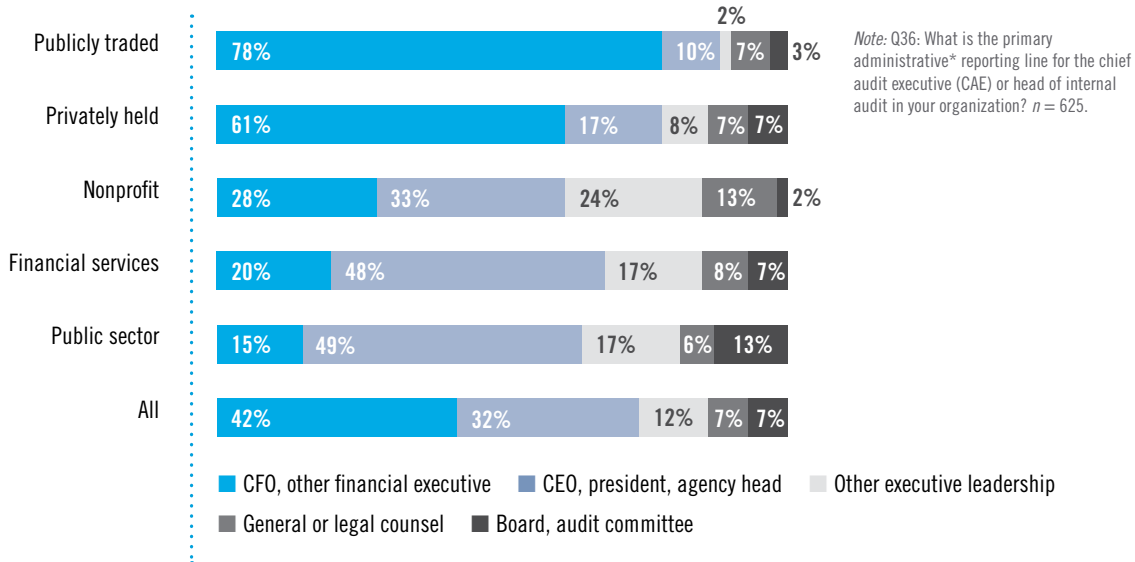
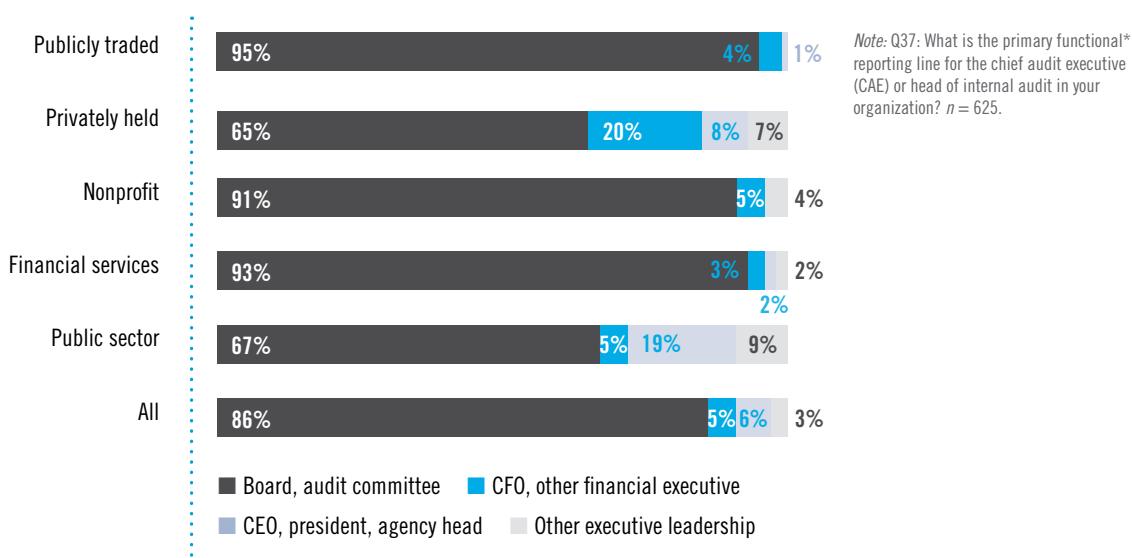


Exhibit B: Functional Reporting Lines



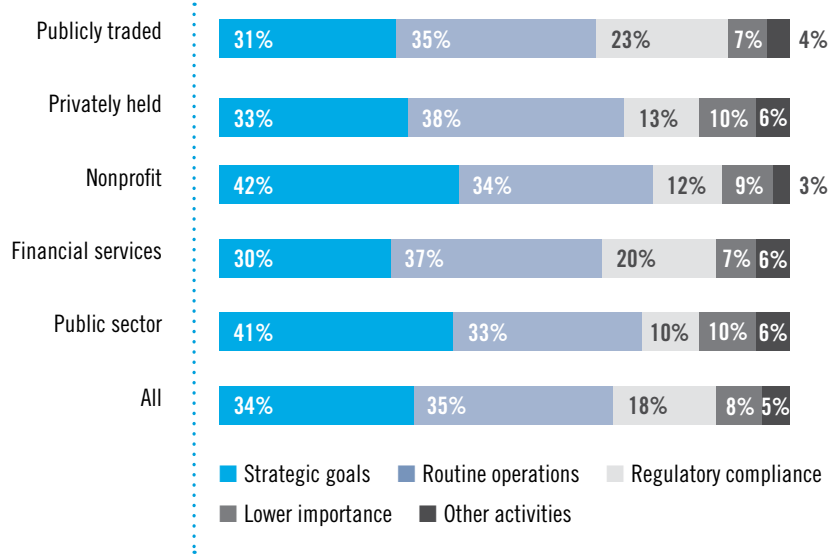
Audit Effort

Exhibit C: Allocation of Audit Effort by Risk Area

Risk Areas	Anticipated Allocation
Operational (not included elsewhere)	17%
Compliance/regulatory (not related to financial reporting)	16%
Financial reporting (including Sarbanes-Oxley testing)	14%
IT (not covered in other choices)	9%
Financial areas other than financial reporting	8%
Cyber (prevention and/or recovery)	7%
Enterprise risk management programs and related processes	6%
Fraud identification and investigation (not covered in other audits)	5%
Governance and culture	4%
Support for external audit	4%
Management of third-party relationships	4%
Cost/expense reduction or containment	3%
Sustainability or other nonfinancial reporting	1%
Other risk category not listed	2%

Note: Q48: Looking ahead over the next 12 months, please indicate what percentage of your audit plan you anticipate will be allocated to each of the risk categories listed. *n* = 636.

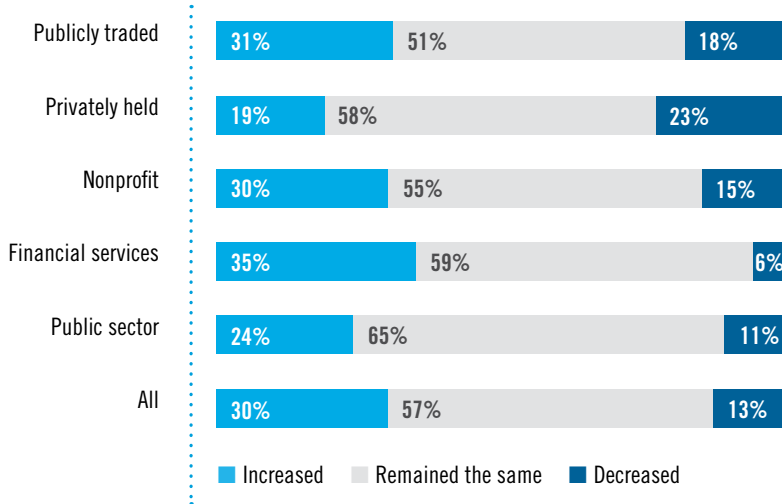
Exhibit D: Allocation of Audit Effort to Strategic Goals



Note: Q51: What percentage of your total audit effort addresses each of the following groups of organizational activities? Total must equal 100 percent. $n = 625$.

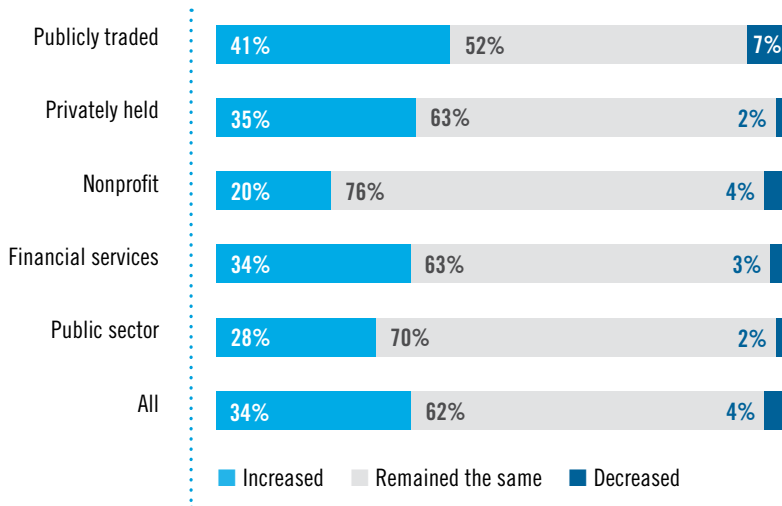
Staffing

Exhibit E: Internal Audit Staff Changes in the Past 12 Months



Note: Q39: Looking back over the past 12 months, the number of full-time equivalent staff within your internal audit department has: increased, decreased, remained the same, not sure. (Choose one.) *n* = 623.

Exhibit F: Expected Internal Audit Staff Changes in Next 12 Months



Note: Q45: Looking ahead at the next 12 months, do you expect the number of full-time equivalent staff within your internal audit department to: increase, decrease, remain the same, not sure. (Choose one.) *n* = 610.

Internal Audit Skills

Exhibit G: Internal Audit Skill Importance Compared to Collective Competency

Internal Audit Skills	Importance*	Competency is Adequate**
Analytical/critical thinking	95%	95%
Communication skills	94%	90%
Understanding the audit process	85%	96%
Persuasion and collaboration	83%	88%
Business acumen	80%	93%
Understanding of professional ethics	79%	97%
Innovative thinking	77%	79%
Process improvement	67%	87%
Internal audit management/supervision	66%	92%
Accounting and finance	65%	97%
Industry-specific knowledge	63%	91%
Risk management assurance	61%	86%
Basic IT knowledge	60%	85%
Understanding the IPPF®	58%	89%
Governance and culture	56%	86%
Data mining and analytics	50%	62%
Cybersecurity and privacy	48%	60%
Fraud investigations and/or auditing	41%	83%

*Note 1: Percentage of those who chose “most” or “very” essential for Q54. Please indicate the degree to which the following skills are essential to your audit function’s ability to perform its responsibilities. *n* = 636.

**Note 2: Percentage of those who chose “strongly agree” or “somewhat agree” for Q19. Please indicate your level of agreement that your audit team collectively possesses the knowledge, skills, and other competencies needed to perform in each of the following areas. *n* = 636.

Notes

1. The IIA collected data from 636 respondents, including 552 CAEs and 84 directors/senior managers, in an online survey from Oct. 5-Oct. 26, 2017.
2. 2017-2018 NACD Public Company Governance Survey, National Association of Corporate Directors, 2017. [Executive Summary](#).
3. Hugo Sarrazin and Paul Willmott, “[Adapting Your Board to the Digital Age](#),” McKinsey Quarterly, July 2016.
4. Enterprise Risk Management Initiative staff and Protiviti, “[2018 Top Risks Report: Executive Perspectives on Top Risks for 2018](#),” page 6, last updated Dec. 7, 2017.
5. Marshall Goldsmith, *What Got You Here Won't Get You There*, revised edition (New York: Hachette Books, 2007).
6. IIA–France, IIA–Italy, IIA–Netherlands, IIA–Spain, IIA–Switzerland, IIA–United Kingdom and Ireland, “[Risk in Focus: Hot Topics for Internal Audit 2018](#),” European Institutes of Internal Auditors, October 2017, page 36.
7. Q29: How important is it for your internal audit department to become more agile in the future? n = 636.
8. Q27: To what degree do you consider your internal audit department to be agile? n = 635.
9. Q28: How would internal audit stakeholders most likely see internal audit's agility expressed? Response options were “in short-term tactical actions,” “in medium-term changes in focus and resources,” and “in longer-term strategic shifts in objectives.” n = 636.
10. For a case study, see Ruth Prickett “[Agile Performer](#),” *Internal Auditor*, The Institute of Internal Auditors, December 2017, page. 43.
11. Q17: Please rate the desirability of different types of professional degrees when recruiting. n = 616.
12. Q14: For which of the following competencies are you actively recruiting? Select all that apply. n = 636.
13. Q31, Option 3: My internal audit department challenges its own status quo, compared to question 27, To what degree do you consider your internal audit department to be agile? n = 635.
14. “[The Innovative Internal Auditor](#),” *Internal Auditor*, The Institute of Internal Auditors, June 2017, page 49.

15. Q33: Which of the following drives innovation in your internal audit function?
Select all that apply. n = 633.
16. Q24: Please indicate the level of residual/net risk (risk after consideration of extent and effectiveness of policies, procedures, and internal controls) for each of the following objectives concerning data analytics in your organization. Option 1: Ability to respond to changing needs and requirements. n = 522.
17. Q44: Please indicate your level of agreement with the following statement:
The internal audit activity at my organization is sufficiently resourced with competent and objective professionals able to carry out the internal audit plan. n = 634.
18. Q13: Please indicate the level of difficulty in recruiting talent at each level: director, manager, experienced staff auditor, entry-level staff auditor. n = 569.
19. Q14: For which of the following competencies are you actively recruiting? Select all that apply. n = 636.
20. Q18: What are the significant barriers you face when recruiting for positions on your audit team? Select all that apply. Results include: lack of qualified candidates (65%); salary limitations/earnings potential (49%); budget restrictions (45%). n = 636.
21. Q17: Please rate the desirability of different types of professional degrees when recruiting. n = 616.
22. Q54: Please indicate the degree to which the following skills are essential to your audit function's ability to perform its responsibilities. Results include: data mining and analytics (50%); cybersecurity and privacy (48%). n = 636.
23. Q19: Please indicate your level of agreement that your audit team collectively possesses the knowledge, skills, and other competencies needed to perform in each of the following areas. Results include: data mining and analytics (62%); cybersecurity and privacy (60%). n = 618.
24. Q2: Does your organization have an audit committee, board, or similar oversight body? n = 635.
25. Q4: Percentage of audit committee meetings attended by CAE. n = 586.
26. Q11: Which best describes the CAE's access to the audit committee? n = 587.
27. Q8: To what level do you disagree or agree with the following statements: n = 596.
28. "Times Call for Liberal Action, Says Kennedy," Lodi (Calif.) *News-Sentinel*, May 13, 1961, page 3.
29. Q56: For which type of organization do you work? n = 625. Q60: What is the primary industry classification of the organization for which you work? n = 636. Q61: In which part of the financial services sector do you work or provide audit services? n = 189.

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