

Does a disrupted Internal Audit function mean a stronger strategic partner?

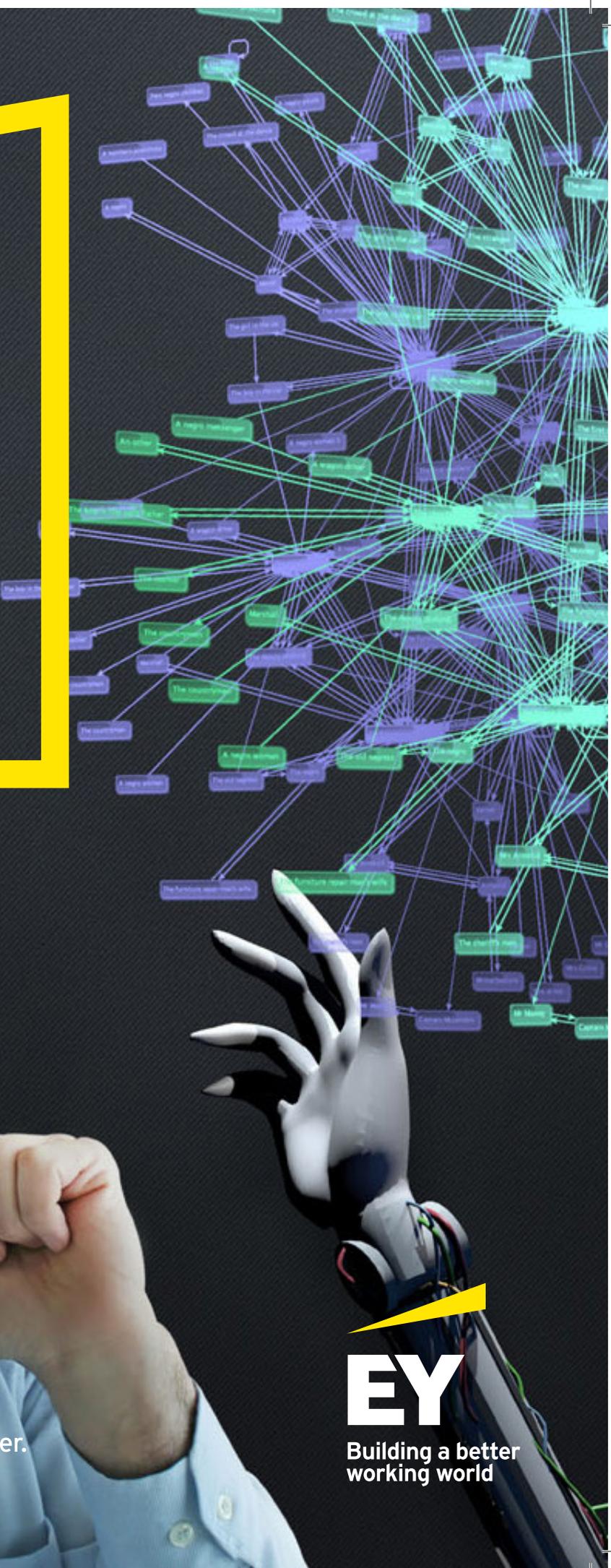
The future of internal audit will require significant disruption to keep pace with global change.

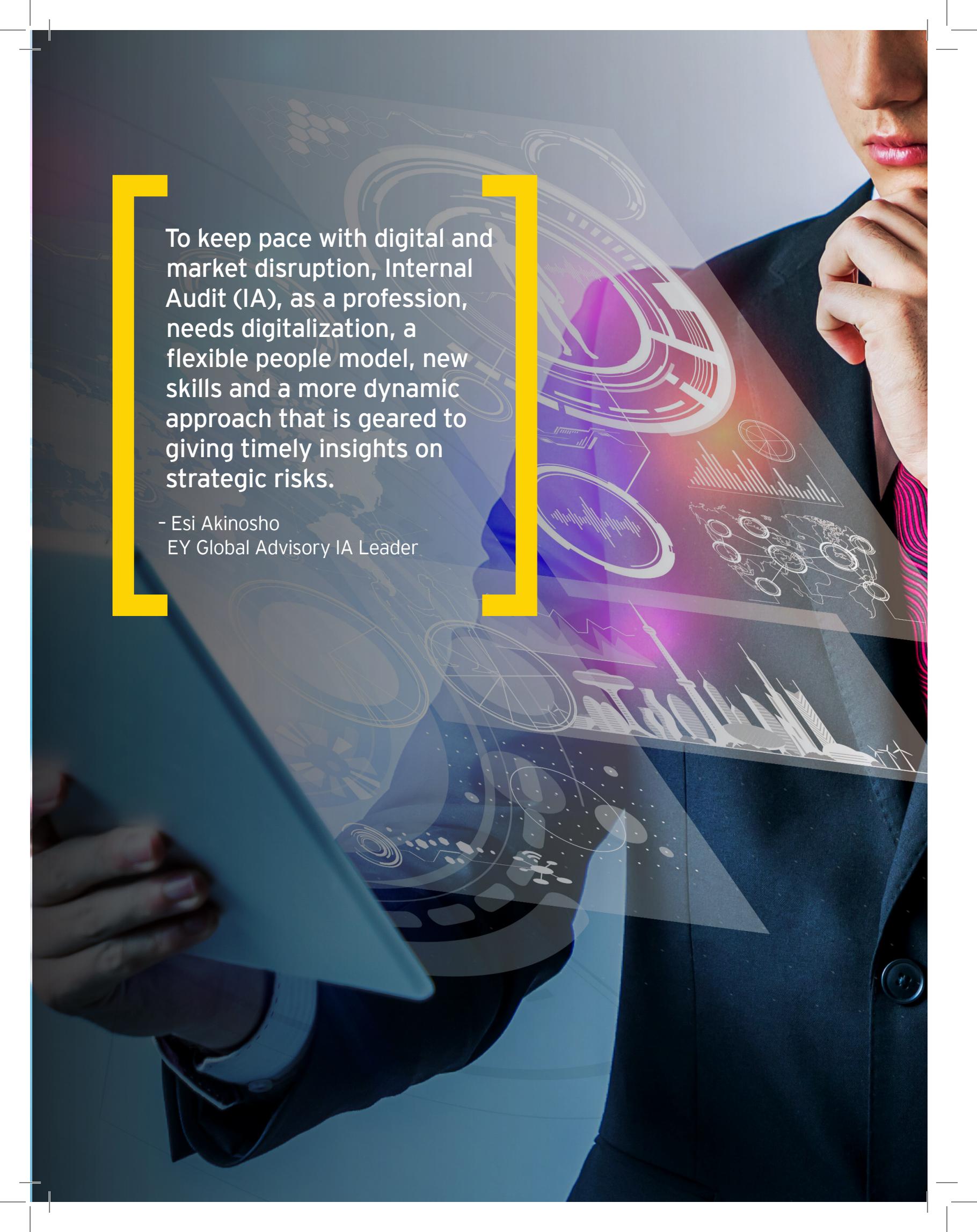


The better the question. The better the answer.
The better the world works.

The EY logo, consisting of the letters 'EY' in a bold, white, sans-serif font. A yellow diagonal line is positioned above the 'Y'.

Building a better
working world





To keep pace with digital and market disruption, Internal Audit (IA), as a profession, needs digitalization, a flexible people model, new skills and a more dynamic approach that is geared to giving timely insights on strategic risks.

- Esi Akinosho
EY Global Advisory IA Leader



Converging forces will challenge the efficacy and relevance of IA, including:

- ▶ Pace of change
- ▶ Disruptive technologies
- ▶ Different business models
- ▶ Changing workforce structure
- ▶ Increasing regulatory requirements
- ▶ Globalization

A case for change

Although no one can predict the future, the rapid pace of change in the global marketplace suggests there is one certainty for all organizations, regardless of location or sector: the status quo is no longer acceptable. Many companies are embracing new technologies, restructuring their business models in response to changing risk profiles and using alternative strategies to satisfy their resource needs. IA has been “transforming” for the past 20 years, making incremental improvements that have helped the function do the same things faster (limited data analytics and selectively leveraging technology) with a better focus on risks (risk-based audit plans); however, the basic approach and methodology of IA have not substantially changed. The case for disruption has never been more real for the profession. To continue to instill trust in the organization - allowing Management to maintain its confidence to take the risks needed to achieve the long-term strategic objectives of the organization - IA must embrace digitalization.

Digitalization: the game changer

Business disruption around the world is creating opportunities with unprecedented speed for companies. Digitalization is enabling companies to not only react to change, but to proactively improve their ability to anticipate consumer preferences, develop better ways to deliver products and services, and penetrate new markets. However, new agile, digitally enabled companies are able to scale and compete effectively with industry incumbents, giving them a competitive advantage in a global digital world. It seems the only constant is change, requiring organizations to continually assess and adjust their strategic vision and underlying operations to keep up with the disruption in the marketplace and to get ahead of the competition.

IA is uniquely positioned to provide so much more.

- ▶ What if IA kept ahead of emerging risks and was able to assess and quantify them quickly, possibly enabling the organization to turn those risks into opportunities?
- ▶ What if IA no longer performed financial and compliance testing, but instead managed a series of online dashboards to detect errors?
- ▶ What if IA could provide a real-time view of the status of risk management in every area of the company at any point in time?
- ▶ What if IA managed a flexible talent model that allowed them to bring in the right resources with the right skills at the right time?



Is IA ready to respond to changes in an organization’s risk profile and digitalize and deliver more forward-looking insights and strategic advice?

What will IA look like in the future?

In light of the pace of disruption and resulting changes occurring in the business, IA needs to change what it does, how it does it and who actually performs the work.

The mandate will remain substantially the same; however, there will be a shift in focus and IA functions must:

- ▶ Be highly connected, agile, proactive and forward-looking
- ▶ Continue to assess and challenge the efficiency and effectiveness of internal controls
- ▶ Be involved in the most strategic activities of the organization
- ▶ Harness emerging technology for better and more predictive risk mitigation outcomes
- ▶ Challenge the risk framework and view to also account for upside and outside, in addition to downside risks

Be agile and dynamic

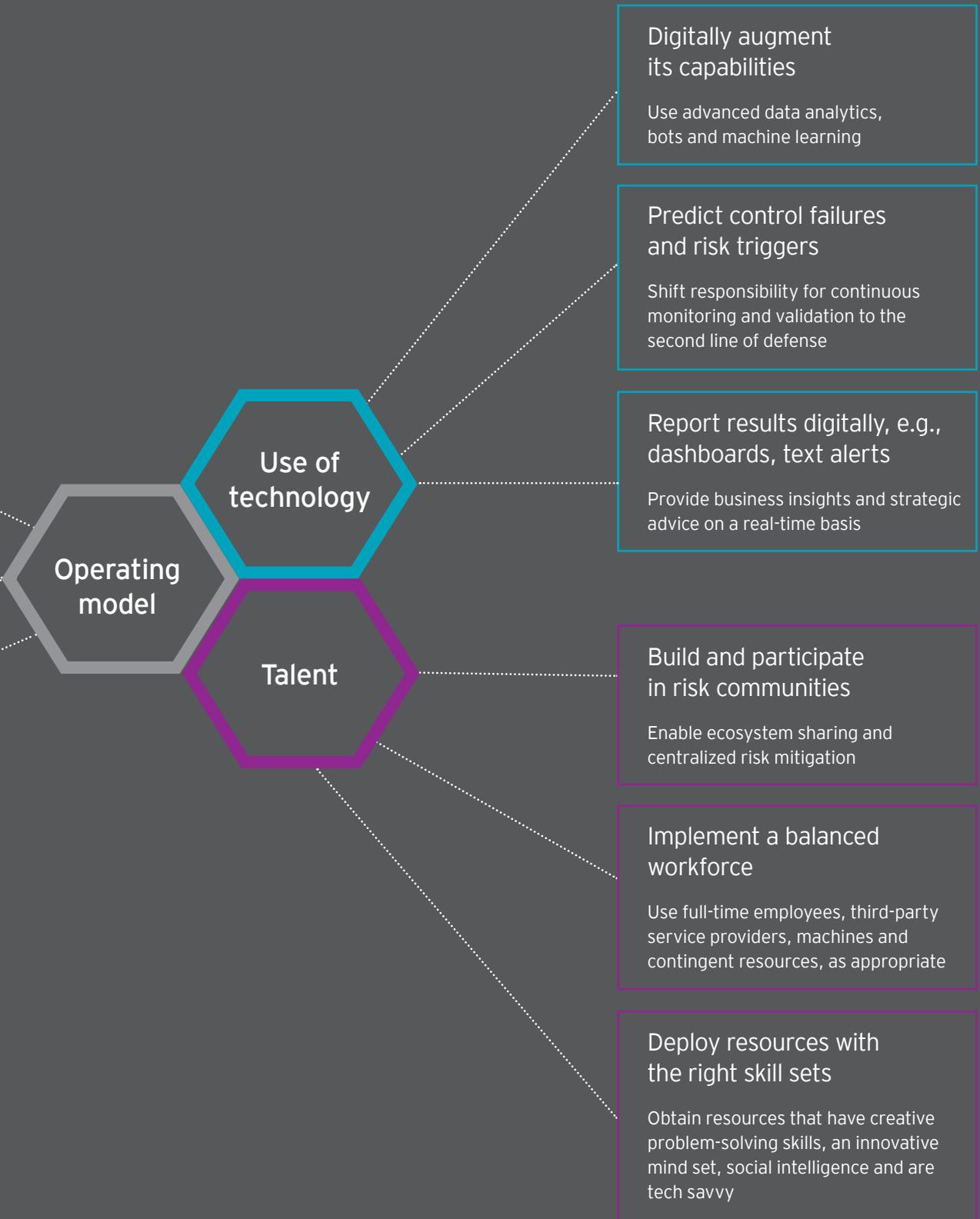
Use technology-enabled risk assessment process

Apply more judgment

Focus attention on emerging risks and outcomes

Provide dynamic outputs

More real-time outputs to deliver its messages and meet stakeholder needs





The global risk landscape continues to change rapidly, requiring companies to direct more attention to risks arising outside of their organization. IA needs to keep pace with these changes to be able to provide strategic advice.

What we will do (mandate)

Despite the level of disruption occurring in the business landscape, IA's mandate to provide assurance, business insights and strategic advice has not and does not need to change. However, striking the right balance between assurance and advisory projects and how the mandate is executed should. An IA mandate is not "one size fits all." IA assurance is broader than an assessment of compliance with financial and regulatory requirements. It includes working with management to understand all of the organization's risks to determine if they are properly identified, managed and mitigated by the business. As the market faces disruption, organizations are reassessing how they look at and manage risk. An updated view of the risk framework includes the following types of risk:

- ▶ Upside - risks that directly relate to an organization's ability to execute its business strategy and objectives, and provide organizations with a positive opportunity for value creation and growth (e.g., return on assets, market penetration, talent management)
- ▶ Downside - risks that only represent a negative outcome and an organization is focused on eliminating, avoiding, mitigating or transferring in a cost-effective manner (e.g., employee fraud, regulatory compliance, information security)

- ▶ Outside - risks that can have positive and negative impacts but are unpredictable because they are beyond the organization's control (e.g., geopolitical, competitive shifts, natural disasters)

Historically, organizations and IA functions have been focused on downside risks, but in the future there is a need to expand the focus to all three categories to continue giving stakeholders confidence in the age of disruption. If the IA function is truly providing leading-class assurance, it is going beyond financial and compliance internal controls to assess the areas that matter most to the company, including strategy, operations and outside market forces.

An organization's culture may influence the scope of the IA mandate and should not be underestimated. IA's stakeholders may not be aware of all that IA can deliver to help the organization navigate change and its impact on the risk profile. Building a business case supported by benchmarking and practical examples, including deliverables, and communicating what IA is capable of will help IA gain consensus of key stakeholders around the enhanced role of the function. IA should also be engaged early and often during the development of new systems, processes and products to provide timely advice regarding control design and to continue helping management drive further efficiencies and effectiveness during implementation and beyond.

Dynamic approach

How we will do it (operating model and use of technology)

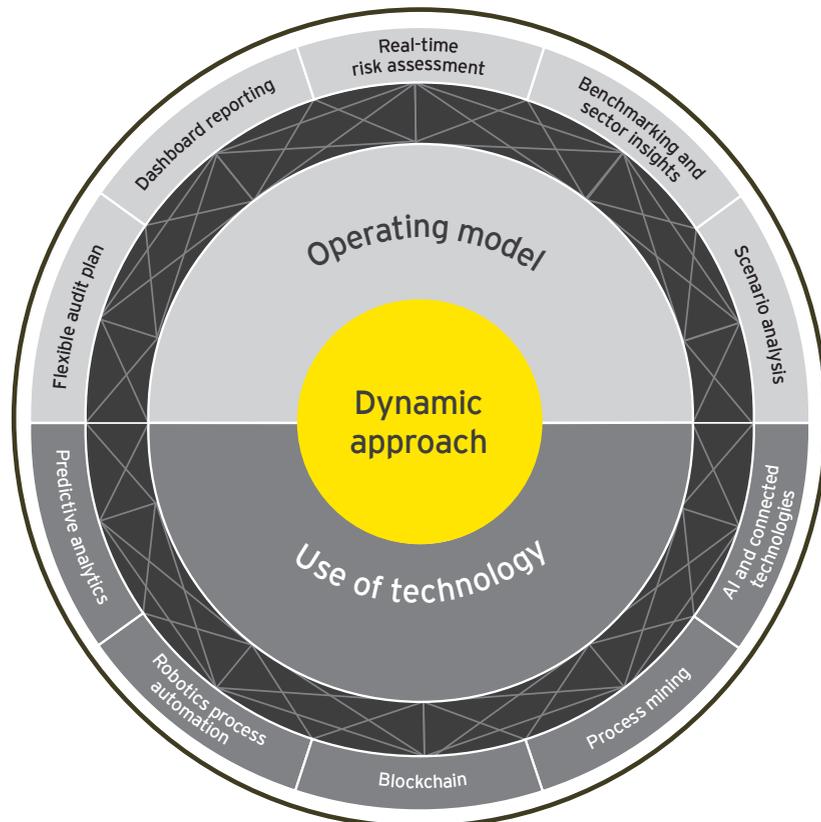
The operating model will feature an agile and dynamic risk assessment process, enabled by technology that allows the function to respond to the evolving risk landscape. IA must incorporate emerging technologies (robotic process automation, artificial intelligence, machine learning, etc.) as part of this new operating model. This will also allow a variety of dynamic outputs to be utilized on a more real-time basis to deliver feedback based on the needs of different stakeholders.

There are certain characteristics that all IA functions will need to have in the future, including:

- ▶ Flexible - the new approach requires an agile and flexible plan that is in tune with the organization's strategic direction and priorities, and addresses the changing business landscape.

IA should be teaming with the business to identify emerging risks and providing insights and advice regarding how to address them. This is not to say that the risk assessment process will go away. In fact, it is more critical than ever.

- ▶ Proactive - IA efforts should no longer be focused on look-back activities, e.g., transaction testing. Rather, IA should transition the testing and validation of the control environment to the first and second lines of defense and focus its own work on assessing governance, process and control design and the adequacy of the work done by others to provide assurance to its stakeholders. IA should



perform advisory projects that contribute to the company's understanding and evaluation of risks (both existing and emerging), increasing management's understanding and buy-in, and helping management establish short- and longer-term action plans to proactively address the risks.

- ▶ Insightful - too often IA is accused of telling the business what they already know. This is partly based on the approach that is being executed today to provide assurance - a sample of transactions is tested and exceptions

are reported back to the auditee and stakeholders. This leads to the "so what?" question that diminishes the functions view in the minds of its stakeholders. IA needs to be able to paint the bigger picture and understand what is truly going on with the organization. This is where the true advisory value is provided - beyond just root cause analysis. The IA function must be truly discerning in its communications and judgments. Included in this evolution are industry insights, benchmarking, behavioral analysis and so many other tools that IA must be bringing to the table.

IA will need to implement a flexible resource model to have the right people at the right time and in the right place, including:

- ▶ **Core audit staff**
- ▶ **Guest auditors**
- ▶ **Contingent workers**
- ▶ **External service providers**
- ▶ **Staff rotation**

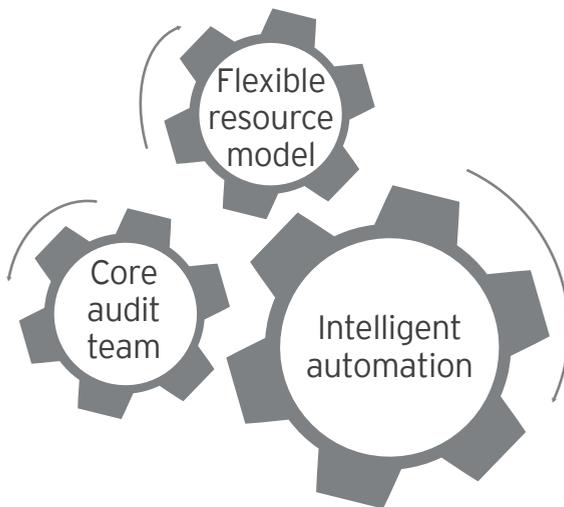
Who will do it (talent)

The digital revolution will disrupt everything we take for granted today about how work is done. For leaders who fail to embrace this new reality, the old mantra “Our people are our greatest asset” could become “Our people are our biggest problem.” New technologies require new skills and, importantly, new ways of working. Just employing people with different skills, or upskilling existing employees, is not the answer. To compete with disruptive startups, organizations need people with a different approach and attitude to their

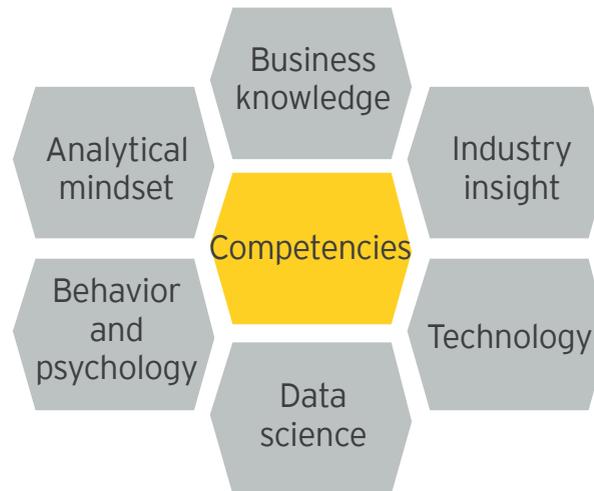
work. Companies that cannot change the way their people work will be marginalized, becoming irrelevant to customers, shareholders and employees themselves.¹

The need to change who does the work and how they do it applies across the entire organization and IA is no exception. A new workforce model, enabling IA to focus on purposeful, value-added work will be required. These changing workforce dynamics will require IA audit to develop a more flexible, adaptive and collaborative work environment.

High performing teams



Resource mix



Skill model

¹ EY “In the workforce of the future, will your people still be your greatest asset, or your biggest problem?” <https://betterworkingworld.ey.com/workforce/will-your-people-remain-your-greatest-asset-or-become-your-biggest-problem>.

A call to action

The IA profession has a unique opportunity to embrace digitalization and lead by example. While it is a journey to get to the future state of the IA profession, it is one that must be started now.

The following are some key steps IA should take now to lay the foundation for its future state:

- ▶ Understand the organization's objectives and future vision
- ▶ Define the future state for IA with a clear purpose and a mandate that aligns to the organization's and enables the company to achieve its strategic objectives

- ▶ Assess the current IA operating model, resource model and technology footprint to determine how they will enable the future state of IA
- ▶ Review the IA life cycle to identify opportunities to automate and innovate to better position the function as a strategic advisor

As the foundation is solidified, IA should take the following actions to continue to drive to its future state:

- ▶ Build a business case to demonstrate IA's capabilities and its evolving role with digitalization and communicate it broadly and often to stakeholders

- ▶ Drive efficiencies in financial and compliance risk coverage to free up resources and time to focus on strategic risks and the future state of the function
- ▶ Start a process of transformation – technology development and deployment, skills sourcing, branding initiatives – to move toward the future state of IA
- ▶ Remain aligned with the changing business so the function flexes with the changing vision and objectives of the organization



EY contacts

Amy Brachio

Global and Americas Advisory Risk Leader

+1 612 371 8537

amy.brachio@ey.com

Esi Akinosho

Global Advisory IA Leader

+1 713 750 8670

esi.akinosho@ey.com

Lisa Hartkopf

Americas Advisory IA Leader

+1 312 879 2226

lisa.hartkopf@ey.com

Martin Wiedemann

EMEA Advisory IA Leader

+49 711 9881 27466

martin.wiedemann@de.ey.com

Sing Hwee Neo

Asia-Pacific Advisory IA Leader

+65 6309 6710

sing-hwee.neo@sg.ey.com

Masami Koike

Japan Advisory IA Leader

+81 3 3503 1110

masami.koike@jp.ey.com



EY | Assurance | Tax | Transactions | Advisory

About EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

© 2018 EYGM Limited.
All Rights Reserved.

EYG no. 010555-18Gbl
1803-2624237
ED None

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax or other professional advice. Please refer to your advisors for specific advice.

ey.com