



ISSUE 115

BOARD PERSPECTIVES: Risk Oversight

GETTING MORE FROM INTERNAL AUDIT IN THE DIGITAL AGE

With digitization fueling innovation and change, two questions arise: Is internal audit adjusting quickly enough to innovate and embrace underlying technologies, and should the board care?

In a world of rapid change on almost every front in which organizations must adapt and grow or risk decline and their ultimate demise, everybody faces the same reality — either improve continuously their efforts to contribute sustainable value or be left behind. The chief audit executive (CAE) is no exception. As the risks and complexities companies face change, so do the focus, skill sets and capabilities needed by internal audit.

Key Considerations

In the digital age, internal audit must innovate and transform itself into an agile, multiskilled and technology-enabled function — a “next-generation” function. It must be able to recognize emerging risks and changes to the organization’s risk profile quickly and

efficiently enough to incorporate them in a timely manner into the audit plan so they can be addressed in the assurance the function delivers. To deliver stronger assurance and more valuable insights to the business in an efficient manner, a next-generation function embraces a holistic approach that focuses on competencies, qualities and components falling into three broad categories:

Governance includes the strategic vision, organizational structure and resource management of the function itself.

Methodology is the “how” of transformation, or the body of methods, rules and procedures guiding the function’s operations from risk assessment to execution to reporting.

Enabling technology includes relevant tools of the digital age — process mining, analytics, robotic process automation, machine learning and artificial intelligence (AI).

Traditional methodologies, long-trusted stand-alone point solutions addressing specific needs and conventional thinking simply can't accomplish these tasks efficiently at the speed of change that is occurring. Many CAEs see that internal audit tools and techniques are evolving rapidly, stirring excitement about transformation possibilities and innovation within the function. In polling at various webinars and conference presentations, as well as in independent research¹ conducted by Protiviti, a strong majority of participants consistently indicate that they are undertaking next-generation auditing initiatives.

What does this mean, and why should the board care? Next-generation internal audit functions have three essential objectives — improve assurance by increasing focus on key risks; make internal audit more efficient; and provide deeper, more valuable and timelier insights from audit activities and processes. These objectives are easy to understand. But the mechanisms to implement such changes vary across a range of innovative approaches, tools and governance processes and are intertwined with the innovative culture the CAE tailors to the organization's needs and his or her vision of what next-generation internal audit looks like.

Our research indicates that three out of four functions are undertaking some form of innovation or transformation effort, but also that the adoption of next-generation capabilities is in a relatively early stage. In many instances, implementation of the governance mechanisms, agile methodologies and enabling technologies that comprise the next-generation internal audit model has so far occurred in an ad hoc manner. The message is clear

for the significant number of functions that have yet to begin their next-generation journeys: It's time to get started.²

Common technology activities and tools implemented in next-generation transformations include:

- **Ubiquitous data analyses and advanced analytics** — These capabilities access a broad swath of data to develop a holistic view of risk. This includes analysis of full samples, data-driven flowcharting and leveraging early warning systems using risk thresholds. The mixture of big data, process automation and data analytics offers interactive visualizations and business intelligence capabilities and can help to make time for more strategic analysis to convert data and information to real insights and enable creation of impactful reports.
- **Automated processes** — Robotic process automation is a powerful means of eliminating manual-intensive tasks, allowing auditors to focus sharply on key business risks and areas requiring exercise of professional judgment. Examples of processes that could be automated include reviewing large volumes of contracts to identify high-risk terms or clauses requiring further review and advanced monitoring techniques that drive greater audit coverage, efficiencies and early alerts.
- **Process mining insights** — Process mining extracts data easily from within the company's systems to discover and monitor how a process actually functions. It enables auditors to analyze process data earlier in the audit cycle to quickly identify risks, potential control breakdowns and inefficiencies. This analysis also directs audit focus to those issues and opportunities that truly matter, delivering significant efficiency gains and a more impactful audit process.

¹ 2019 Internal Audit Capabilities and Needs Survey: Embracing the Next Generation of Internal Auditing, Protiviti, March 2019, available at www.protiviti.com/US-en/insights/internal-audit-capabilities-and-needs-survey.

² Ibid.

- **AI and machine learning** — These advanced capabilities increase the effectiveness and efficiency of complex testing and provide intricate analysis in real time. Examples include the application of classification and clustering algorithms to data. These purpose-specific algorithms are designed to identify outlier and high-risk transactions and to better stratify populations for risk-based analysis. They also can be used to perform predictive modeling to provide intelligent continuous process auditing.

These digital activities and tools enable internal auditors to translate an increasingly overwhelming amount of data into meaningful, impactful analysis. Coupled with divergent and critical thinking, these capabilities have the potential to steepen the value-delivery curve significantly for internal auditors.

The annual audit planning process so familiar to directors has become a relic of the past. Rarely will an audit plan be executed in its entirety before fresh insights and developments emerge, creating the

need for changes to it. The above digital pathway will lead to the observations and recommendations that board members, senior executives and other stakeholders will value and can act upon quickly in the digital age.

Directors cannot be indifferent to the CAE's level of awareness of digital techniques and tools available for next-generation audit. The reality is that companies are moving to cloud computing and adopting AI, machine learning and other digital practices to conduct business at the speed of innovation. As they do so, an agile methodology enabled with the right skills, resources and technology helps the CAE sustain internal audit's relevance by providing assurance to the board and other stakeholders on the risks that matter most in the most efficient manner. The board should accept nothing less.

Questions for Boards

The board of directors may want to consider the following questions in the context of the nature of the entity's risks inherent in its operations:

- Is the board satisfied with the scope of internal audit's activities in view of changes in the business environment and the company's operations? Are directors getting the assurances they need from internal audit in the appropriate areas?
- Does internal audit have the tools it needs to address the priorities and achieve the coverage set forth in the audit plan? Has internal audit adopted a next-generation strategy that is aligned with the company's risk profile and stakeholder expectations? For example, does the CAE consider deployment of the data and technology-enabled processes and capabilities that would facilitate delivery of cost-effective assurance? Does the board support the CAE's transformation efforts in its oversight?

How Protiviti Can Help

Increasing demand for internal audit functions to take broader and more strategic roles within organizations makes evident the high profile that internal audit has with executives and boards today. As a result of this increased profile, internal audit leaders are searching for ways to broaden their skill sets and scopes of influence. Today's leading functions ensure their organizations become more innovative and explore new technologies, identify and mitigate

emerging risks, develop creative solutions to complex business challenges, and encourage best practices to enhance business performance. As a global leader in internal audit solutions, Protiviti works with audit executives, management and audit committees at companies of virtually any size, public or private, to assist them with their internal audit requirements. Our service offerings support our clients' transition to next-generation auditing capabilities available in the digital age.

Is It Time for Your Board to Evaluate Its Risk Oversight Process?

The TBI Protiviti Board Risk Oversight Meter™ provides boards with an opportunity to refresh their risk oversight process to ensure it's focused sharply on the opportunities and risks that truly matter. Protiviti's commitment to facilitating continuous process improvement to enable companies to confidently face the future is why we collaborated with The Board Institute, Inc. (TBI) to offer the director community a flexible, cost-effective tool that assists boards in their periodic self-evaluation of the board's risk oversight and mirrors the way many directors prefer to conduct self-evaluations. Boards interested in using this evaluation tool should visit the TBI website at <http://theboardinstitute.com/board-risk-meter/>.

Learn more at
www.protiviti.com/boardriskoversightmeter

Protiviti is a global consulting firm that delivers deep expertise, objective insights, a tailored approach and unparalleled collaboration to help leaders confidently face the future. Protiviti and our independently owned Member Firms provide consulting solutions in finance, technology, operations, data, analytics, governance, risk and internal audit to our clients through our network of more than 75 offices in over 20 countries.

We have served more than 60 percent of *Fortune* 1000® and 35 percent of *Fortune* Global 500® companies. We also work with smaller, growing companies, including those looking to go public, as well as with government agencies. Protiviti is a wholly owned subsidiary of Robert Half (NYSE: RHI). Founded in 1948, Robert Half is a member of the S&P 500 index.

Protiviti partners with the National Association of Corporate Directors (NACD) to publish articles of interest to boardroom executives related to effective or emerging practices on the many aspects of risk oversight. As of January 2013, NACD has been publishing online contributed articles from Protiviti, with the content featured on <https://blog.nacdonline.org/authors/42/>. Twice per year, the six most recent issues of *Board Perspectives: Risk Oversight* are consolidated into a printed booklet that is co-branded with NACD. Protiviti also posts these articles at protiviti.com.