2014 state of the internal audit profession study
Higher performance by design: A blueprint for change

PwC's annual survey results suggest that alignment of stakeholder expectations, and matching skills and capabilities to these expectations, helps internal audit enhance the value delivered to the organisation.

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The heart of the matter

Transforming internal audit by design

State-of-the-art buildings are constructed based on a series of detailed blueprints agreed upon by stakeholders, including owners, builders, tenants, and inspectors. The builder then deploys the right skills and capabilities to build with quality against the blueprint. The alignment of stakeholders, a thoughtfully developed blueprint, the right capabilities, and disciplined execution result in a product that is valued by stakeholders and emulated by others. A more traditional or functional building will also be valued by stakeholders, but only if all interested parties agree on what they want and get what they are expecting.

Effective, profitable and well-run companies apply the same level of detailed design, execution and alignment in running their operations. Leaders are purposeful and systematic in defining expectations, establishing performance measures and continually asking for higher levels of performance. Definitive steps are taken to build necessary capabilities to deliver on business expectations, and performance is continually evaluated.

When necessary capabilities do not reside within the organisation, they are obtained or advisors are leveraged in order to fulfill the obligations thoughtfully agreed upon by stakeholders. In our 10th annual *State of the Internal Audit Profession Study,* we take a deep dive into how today's internal audit functions can apply these same principles in order to deliver greater value to their organisations.

This year's study reflects the opinions of more than 1,900 chief audit executives (CAEs), internal audit managers, members of senior management, and board members, who told us that, given adequate resources, opportunities exist for internal audit to increase its value as well as its contribution to the business. At the global level, more than half (55%) of the senior management told us that they do not believe internal audit adds significant value to their organisation. Nearly 30% of board members believe internal audit adds less than significant value. However on the Indian front, 50% of senior management, and 67% of board members believe internal audit does not add significant value. On an average, only 49% (48% for India) of senior management and 64% (66% for India) of board members believe internal audit is performing well at delivering on expectations. While many reported that their internal audit functions made progress during the past year, performance issues identified in prior years' research continue and stakeholders told us the progress has not been sufficient to keep pace with the changing business environment. This year's research once again confirms that today's increasingly complex and risky business landscape has resulted in many internal audit functions struggling to be viewed as valuable. Further, internal audit's ability to build the right capabilities and deliver on expectations continues to be challenged.

"Internal audit services are not restricted to providing assurance and satisfying regulatory compliance requirements. But these things remain core elements of internal audit expectations. However, internal audit also adds a number of other competencies to its arsenal to keep pace with stakeholder expectations. This includes shifting the balance between assurance and advisory to achieve greater business insights. Internal audit now has become more collaborative than before. There is no more 'you' and 'I' and finger-pointing. Internal audit takes up coaching responsibility for the business, driving performance improvement initiatives and closing internal control gaps."

Nagesh Pinge, CAE, TATA Motors Limited, India

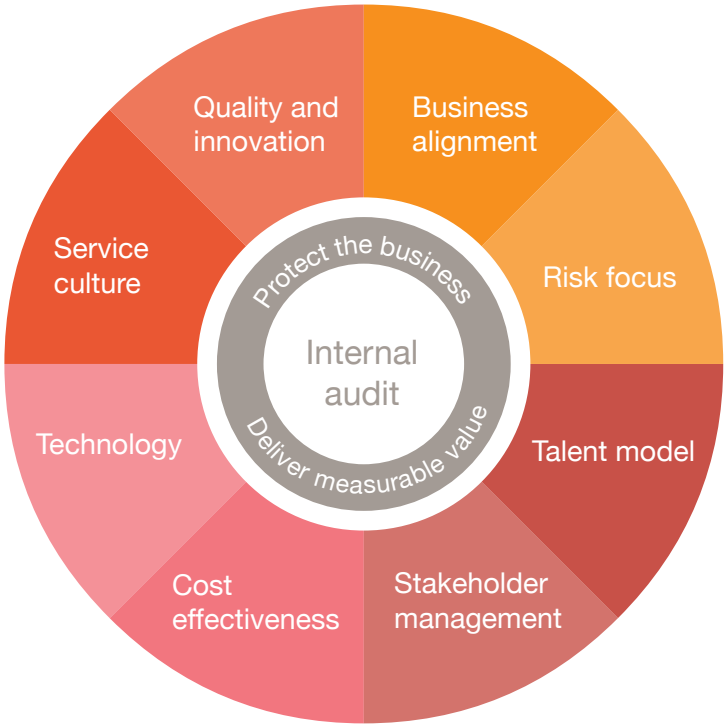
"I wonder if the audit committee has an appreciation for how the pendulum has swung for internal audit. The expectations of internal audit must be very clear and all stakeholders—board, executive officers, line management—must align."

—Chief Compliance Officer, Fortune 50 consumer products company

This year's survey results have brought the drivers of these continuing trends into further focus. In order to build the right capabilities to add maximum value to the organisation, each internal audit function must first define value and ensure alignment of definition and expectation. Therefore, any analysis of performance and value starts with an assessment of expectation alignment. Without clear expectations established, no clear definition of value even exists. Our research indicates that many internal audit functions are responding to a wide variety of stakeholder demands versus taking purposeful action in designing the function around an aligned set of expectations. While internal audit has an important objective to carry out, it must be aligned with the expectations of its stakeholders regarding both the critical risks the organisation faces as well as the expectations of internal audit relative to those risks. These are foundational steps without which internal audit is unable to strategically build the right capabilities, raise its performance and add value.

It is also hard to dismiss the levels of performance we have continued to see since we began studying internal audit through the stakeholder lens three years ago. These challenges continue to be rooted in not having the right capabilities to perform on the eight foundational attributes. Stakeholders reported low levels of performance in multiple areas, including bringing the right level of talent to the organisation, leveraging technology (including advanced data analytics) and delivering cost-effective services. In this year's study, we take a deep dive into these alignment and performance issues to uncover the challenges and reveal the characteristics internal audit and stakeholders are demonstrating in high-performing organisations. Our 2014 survey revealed that when stakeholders expect more, and internal audit is able to deliver at a 'trusted advisor' level of service (that is, meeting a broader stakeholder expectation set, based on a track record of providing value-added services and proactive strategic advice to the business), the following benefits result:

The eight foundational attributes of internal audit



- Performance on the eight foundational attributes is better—by a wide margin—versus functions delivering at an 'assurance provider' level of service (defined as meeting limited expectations focussed on executing effectively and efficiently on an often more traditional audit plan).
- The function is valued by stakeholders at more than twice the level accorded to assurance providers.
- Stakeholders believe the benefits of these internal audit departments far exceeded their costs, by nearly 40% over assurance providers, while for India in particular, the scenario is drastically different since 14% trusted advisors believe that benefits exceed cost as compared to 25% assurance providers.

Our survey results also showed that when the expectations of internal audit's various stakeholders are aligned, the function can perform well and be seen as providing significant value, irrespective of the level at which it's expected to deliver: trusted advisor, assurance provider, or somewhere in between. Functions at the assurance provider level should strive to deliver value by ensuring alignment around their expectation set and then executing at the highest quality within that level. Additionally, internal audit functions at every level should always be looking to add value by expanding their capabilities in emerging areas (e.g., data analytics), leveraging greater subject matter expertise and entering into emerging risk spaces such as compliance, IT security, geographic or product expansion and new acquisitions.

Building a world-class internal audit function that is responsive to growing stakeholder expectations and an expanding risk universe is a matter of deliberate design and collaboration. Organisations that want to craft an internal audit function that delivers optimal value and enables management to make better business decisions should consider these key questions:

- The first step towards generating more value is aligning with stakeholders. Is there alignment of expectation across critical stakeholders?
- When more is expected, internal audit has the opportunity to generate more value. Am I asking for enough? Has historical performance positioned the function to expand the scope of what is expected?
- Higher expectations require increased capabilities. Do we have the right capabilities?

of trusted advisors are providing significant value compared to

of assurance providers

An in-depth discussion

Crafting the blueprint for an aligned, value-enhancing internal audit function

As a critical function of the business in identifying and managing risk, internal audit should be an effective contributor to the priorities of stakeholders and the organisation. That is why, each year, PwC conducts a survey of CAEs and their key stakeholders. Nearly 1,400 CAEs (which, in our study, includes internal audit directors) and more than 520 stakeholders, representing 24 industries and 37 countries, participated in the *2014 State of the Internal Audit Profession Study*. This rich data has given substantial insight into how internal audit is performing and the steps individual functions are taking to increase their contribution to their respective organisations. To gain even deeper insights on survey findings, PwC also conducted one-on-one interviews with more than 125 stakeholders and CAEs across North America, Europe, Australia and Asia.

Further, PwC interviewed certain key regulators across the globe to better understand their expectations of internal audit.

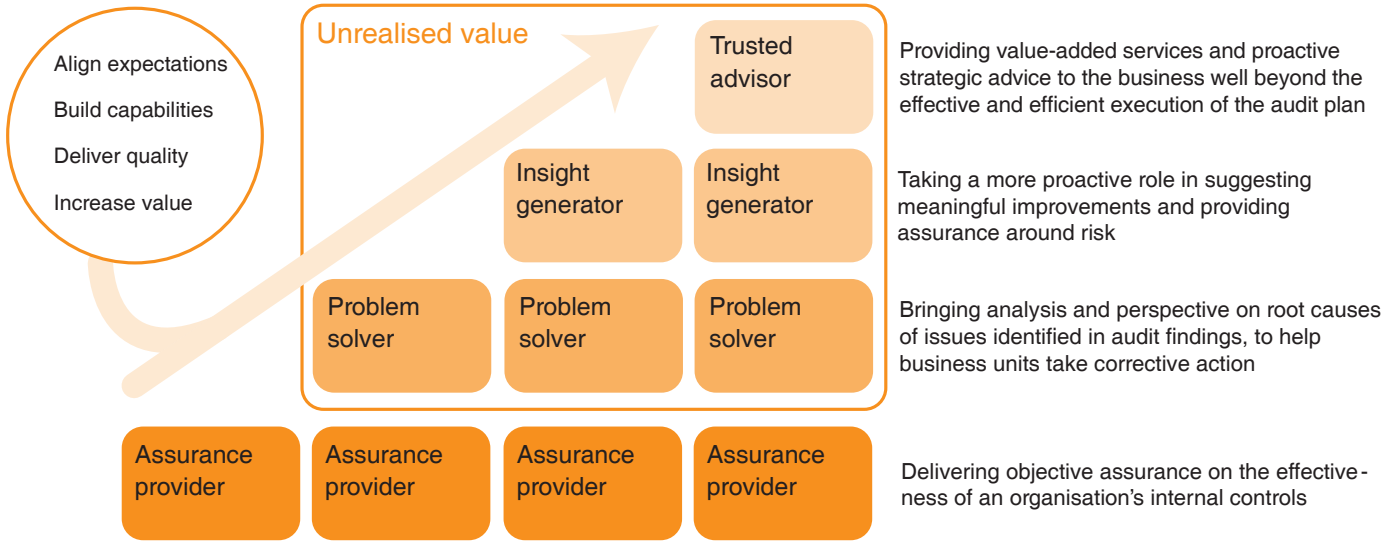
Through our research and experience, we know that internal audit functions can provide value across a spectrum of delivery approaches—from assurance provider to the trusted advisor. Our survey and interviews revealed that those functions add significant value and purposefully decide where they fall on this spectrum as they align capabilities accordingly. However, many others are operating by default rather than by purposeful design.

Internal audit's journey to maximise its contribution is not unlike a builder's journey to construct a world-class building. Several components contribute to the development of any new construction. Both the short as well as the long-term uses of the building must be considered so that it can be designed to be adaptable to future needs. The style of the building must be decided—whether it will be a simple, lower-cost, utilitarian one or a more innovative structure compliant with leading environmental standards and equipped with the latest technologies. The building must also be designed on a blueprint that details each space and the predetermined use or flexibility required from that space. These decisions are made with the input of all constituencies involved in the building's construction and use. Once decisions are made, they are broadly communicated so that every party is aligned on the blueprint prior to construction. Prior to breaking ground, the builder confirms that skilled resources and equipment will be on the job site when needed.

To help board members, senior management and CAEs gain insight into how internal audit can build itself into a world-class structure, realise its full value potential, and maximise its contribution to the business, we present our survey findings in the following five sections:

- Is it time to renovate? The case for change

The journey to capture unrealised value



"We've seen internal audit's role in enterprises continue to change in reaction to events, risks or regulation affecting the company. More time needs to be invested to shift internal audit from being reactionary to getting aligned with the enterprise's strategic needs. When the breadth of expectations of internal audit is agreed upon, enterprises have taken the fundamental first step towards deriving the most out of the function."

—John Tantillo, Partner, PwC US

- Laying the groundwork for value: Expanding the expectation set
- Creating the blueprint: Developing an aligned set of expectations
- Preparing to build: Crafting the capabilities to deliver on expectations
- Sharing the blueprint: Internal audit's communication strategy

Is it time to renovate? The case for change

Last year, PwC's 2013 *State of the Internal Audit Profession Study* identified that many internal audit functions were struggling to maximise the impact of their contribution and were therefore in danger of losing relevance to other risk and compliance functions within the organisation. Twelve months later, while we continue to see leading functions delivering at a high level, the majority of our survey respondents have made minimal progress. Our 2014 survey results indicate that many stakeholders do not believe internal audit is meeting expectations. Fewer than half (45%) of senior management believe internal audit adds significant value. Senior management in India also agrees to the above, with only 50% of them believing that internal audit adds significant value. Board members are somewhat more bullish, with nearly 70% expressing a belief that internal audit adds significant value, but this percentage is more than 10 points lower than in 2013, somewhat undercutting its positive spin. However, there is a drastic fall in the perception of Indian board members' belief of internal audit adding significant value (33% in the current year as compared to 80% last year). This trend could either be due to internal audit failing to keep pace with the changing, complex risk environment, or it could reflect a situation in which internal audit lacks the resources to meet rising board member expectations.

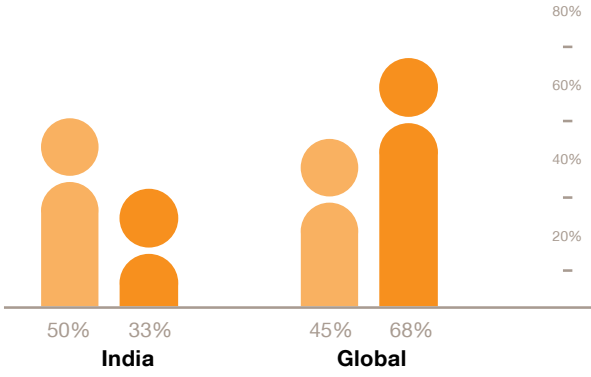
Furthermore, on an average, only 49% of senior management and 64% of board members believe internal audit is performing well at delivering on the foundational attributes and their associated expectations. Even CAEs are critical of their function's performance, with just 65% believing on an average that their function is performing well. Indian respondents reflect the same thinking, with only 48% of senior management, 66% of board members and 60% of CAEs believing that internal audit is performing well at delivering expectations.

To gain a more comprehensive perspective on the expectations and performance of leading internal audit functions, we expanded our evaluation of internal audit's eight foundational attributes to investigate the types of responsibilities leading internal audit functions are delivering on today.

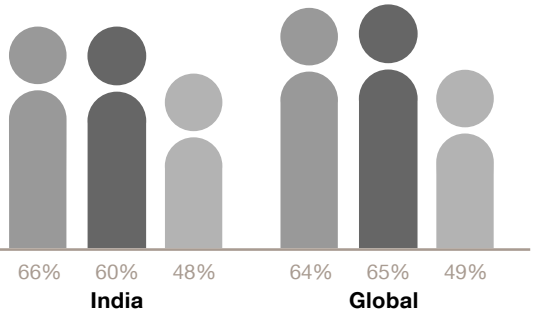
Our survey results indicate a variety of different opinions between board members, senior management and CAEs regarding what is expected from internal audit.

Satisfaction with internal audit value and performance

Percentage of stakeholders reporting internal audit provides 'significant value'



Percentage of 2014 respondents reporting that internal audit 'performs well'[1]



[1]*Represents the average of 'performs well' ratings*

Risk focus and business alignment

Our research identifies varied perspectives between board members, senior management and CAEs as to what they expect from internal audit regarding risk focus and business alignment. For example, focussing on critical risks and issues the company is facing is one of internal audit's foundational attributes and an expectation of most stakeholders. Senior management (85%), board members (90%) and CAEs (96%) are aligned on the expectation that internal audit should focus on critical risks and issues the company is facing. Senior management and CAEs in India are aligned with the global thinking, with 85 and 87% of them respectively expecting internal audit to focus on critical risks as well as issues that their company is facing. However, at the board level, only 66% of respondents harbour a similar view point. How well internal audit performs against that expectation, however, is debatable: 81% of CAEs who believe this is expected of them report they do this well, while only 63% of senior management agree. Among Indian counterparts, 88% of CAEs and 53% of senior management have a similar view. Perhaps the gap indicates that internal audit is not truly focussed on the most critical risks faced by the organisation, and is therefore not aligned with stakeholders on those risks. Alternately, internal audit may be focussed on the right risks but lacks the capabilities to execute effectively against those risks. In our interview process, both of these scenarios were discussed.

There is also agreement on the expectation that internal audit will assess the effectiveness of internal controls, an area in which many internal audit functions are performing well. Approximately, 80% of senior management, 90% of CAEs and 90% of board members believe internal audit is delivering on assessing the effectiveness of internal controls. Similarly, for the Indian scenario, 89% of senior management, 96% of CAEs and all the board member respondents believe that internal audit is performing well on this front. This is good news,suggesting that as internal audit expands its capabilities and reaches high performance on basic assurance provider expectations around testing of financial, operational, and compliance controls, it will then be able to purposefully design its journey up the spectrum toward 'trusted advisor' status.

On the expectation that internal audit align its scope and audit plan with stakeholder expectations, CAEs and other stakeholders are not in full agreement, with 94% of CAEs believing the function has this mandate and only 85% of senior management and 80% of board members believing the same. CAEs and senior management in India are aligned with the global view, with 95 and 85% of them respectively believing in aligning the scope as well as the audit plan with stakeholder expectations. However, only 66% of board members have a similar perspective. Further, there is varying perspective on the performance against this expectation, with 85% of CAEs, 68% of senior management, and 76% of board members who expect such alignment believing internal audit delivers on this goal. In India, 89% of CAEs and 76% of senior management believe the same.

Expectations and performance on risk focus and business alignment

Expectation: % who expect this from internal audit (base = total survey responses)

Stakeholder management and service culture

Stakeholders were not well aligned in their expectations of internal audit in the areas of stakeholder management and delivering quality through a client service culture. In addition, performance against these attributes was reported to be fairly low. For example, 89% of CAEs believe they are expected to provide timely, proactive advice to senior management on current and emerging issues. This compares to 81% of senior management. The thought process of Indian CAEs is aligned with the way global CAEs think, with 89% of them believing they are expected to provide timely as well as proactive advice to senior management. Seventy per cent of senior management from India have a similar view point. From a performance perspective, there was a 20-point gap between senior management's and CAEs' perception of whether internal audit was performing well on this attribute (41 and 61%, respectively). Indian CAEs as well as senior management agree with each other's opinion, with 58% of CAEs and 57% of senior management believing that internal audit performed well on this attribute.

Expectations and performance on stakeholder management and service culture

Expectation: % who expect this from internal audit (base = total survey responses)

When it comes to engaging and managing a relationship with stakeholders, 77% of CAEs said this was an expectation of internal audit, while 55% of senior management and just 36% of board members believe this is a critical expectation of the function. The opinion of Indian counterparts varied in this regard. Sixty-nine per cent of CAEs, 45% of senior management and only 34% of board members believe this is a critical expectation of internal audit. Among the 55% of senior management who expect this from internal audit, just over half (54%) believe the function does it well. With respect to Indian respondents, 70% of CAEs and only 56% of senior management believe internal audit executes this task well.

"The CAE is expected to select the 'best' resource to get the work done, which may include outsourcing, bringing in others—the best in the industry—to increase the knowledge of your own team and get different perspec-tives on issues. We leverage the co-source relationships to learn different ways of doing things within internal audit."

Melvin Flowers, Corporate Vice President of Internal Audit, Microsoft, US

Significant differences of opinion were also evident regarding the identification of thematic issues an organisation is facing. While 79% of CAEs believe this is expected of them, just 63% of senior management and 65% of board members agree. In the Indian scenario, 69% of CAEs, 60% of senior management and 67% of board members believe that identifying thematic issues the organisation is facing is expected of them. Among those in senior management who believe that identification of thematic issues is expected of internal audit, only 39% report that the function does it well. In India, only half of the CAEs (51%), 25% of senior management and 30% of the board members think that internal audit executes this task well. When asked if promoting quality improvement and innovation was part of internal audit's expectations, stakeholders had different perspectives: 56% of senior management agreed, compared to 69% of board members and 77% of CAEs. Among the board members who expect this, just 64% believe internal audit does it well. On the other hand, the Indian perception varied with 65% of CAEs, 66.6% of board members and only 50% of senior management believing that promoting quality improvement and innovation is part of internal audit's expectations.

Based on our research, internal audit could take several steps towards building a better function. Do CAEs know how to meet and exceed stakeholder expectations, when these expectations vary so widely? In order for internal audit to be purposeful in identifying the capabilities and skills it needs to deliver quality, it must first align its stakeholder expectations to form a comprehensible and focussed set of goals.

Laying the groundwork for value: Expanding the expectation set

As CAEs work with their stakeholders to build alignment, the conversation needs to include what the groundwork for value looks like today and into the future, since the definition of value will differ for each stakeholder.

By aligning on expectations and having the right capabilities, internal audit functions can add significant value to their organisation as either an assurance provider or trusted advisor. Our survey results indicate that those with a broader expectation set (trusted advisor) are more often seen as adding significant value. We believe this is a result of those internal audit functions having the ability to bring in a broader range of skills and capabilities to the organisation. However, our survey results show that, while harder, it is possible to perform well against limited expectations and be valued by stakeholders, although typically this involves executing on more traditional audit plans—the role of an assurance provider. Regardless of the expectation set (assurance provider or trusted advisor), internal audit has the opportunity to drive greater value to the organisation by expanding capabilities and skill sets.

In organisations where internal audit's expectations are narrow, yet where CAEs have gained consensus on those expectations and aligned capabilities to deliver, some stakeholders reported receiving value. In our construction metaphor, this is analogous to a builder constructing a highly efficient building designed to fulfill a narrow, highly specific purpose for its tenants. Performance scores show that 26% of internal audit functions with narrow expectations (that is, assurance providers) are performing well on the most foundational expectations and are adding significant value. However, 55% of the functions in this group were perceived as performing poorly and adding only some to little value.

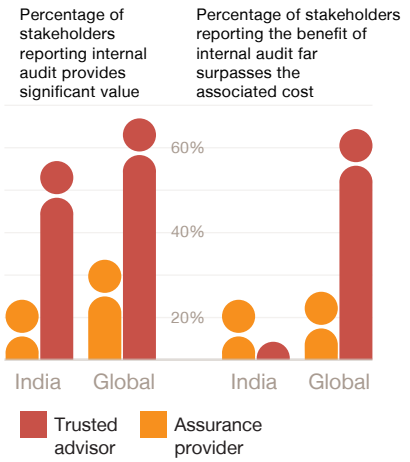
In contrast, our survey results indicate that when an organisation has broad expectations of internal audit, and the function has invested in the right capabilities to deliver on these expectations, stakeholder satisfaction and performance is significantly higher and internal audit is viewed as a trusted advisor. When internal audit is viewed as a trusted advisor, twice the percentage of stakeholders (67%) say the function adds significant value, versus just 33% when the function's expectation set is limited to that of assurance provider. Indian respondents seem to share the global view, with twice the percentage of stakeholders (57%) believing the function adds value when viewed as a trusted advisor in comparison to only 25% of stakeholders believing the same when viewed as an assurance provider. In addition, when internal audit is viewed as a trusted advisor, more than twice the percentage of stakeholders report that the function's benefit far surpasses its associated cost. The Indian figure however varies drastically as only 14% of stakeholders who rated their internal audit function viewed as a trusted advisor believed that the function's benefit far surpasses its cost.

SPX's CFO Jeremy Smeltser expects internal audit to be involved in areas of change in the business, integrating emerging risk areas into the audit plan and performing audits both around controls and integrity of the risk behind the business strategy. Smeltser also noted that internal audit is proactive because they have earned a seat at the table. As new issues arise, internal audit is asked to come in and is always able to share thoughts across the organisation because they have the benefit of perspectives from all levels of the business. Senior management expects their involvement. In this organisation, being a trusted advisor does not take away from internal audit's core responsibility of providing value protection to the company, nor does it impede the function's ability to be objective. When expectations are broad and internal audit has support from stakeholders, it is able to align capabilities to meet these broader expectations and bring a relevant, well-thought-out perspective on the organisation's critical risks. The ability to continually provide high-quality perspectives to stakeholders earns internal audit a seat at the table and allows it to deliver more business-relevant perspectives and increase the value it delivers on initiatives that matter most to the organisation.

Our evidence shows that internal audit can deliver greater value for the enterprise if stakeholders expand their expectations and the function expands its capabilities in response. In the same way a building constructed and equipped for multi-purpose use meets the needs of more tenants and enjoys greater occupancy, a more relevant internal audit function will enjoy enhanced stakeholder satisfaction and earn a place as a trusted advisor. Among companies in which internal audit is accepted as a trusted advisor, 56% reported the function was adding significant value and performing well. The Indian respondents' views were aligned with 50% of them believing that internal audit was adding value and performing well. Higher expectations demand stronger capabilities, which beget higher performance. In addition, broader expectations infer internal audit is covering more risk areas, and broader risk coverage can make the function more relevant as it expands its skill sets.

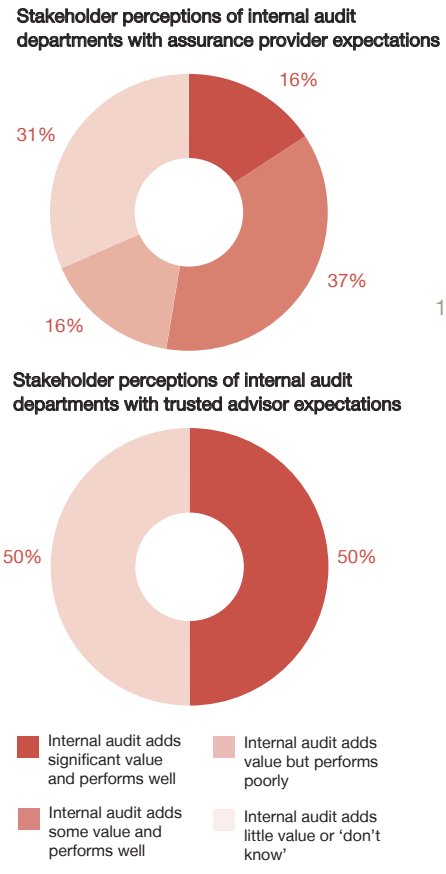
Profile of trusted advisors

Trusted advisors are more valued by stakeholders

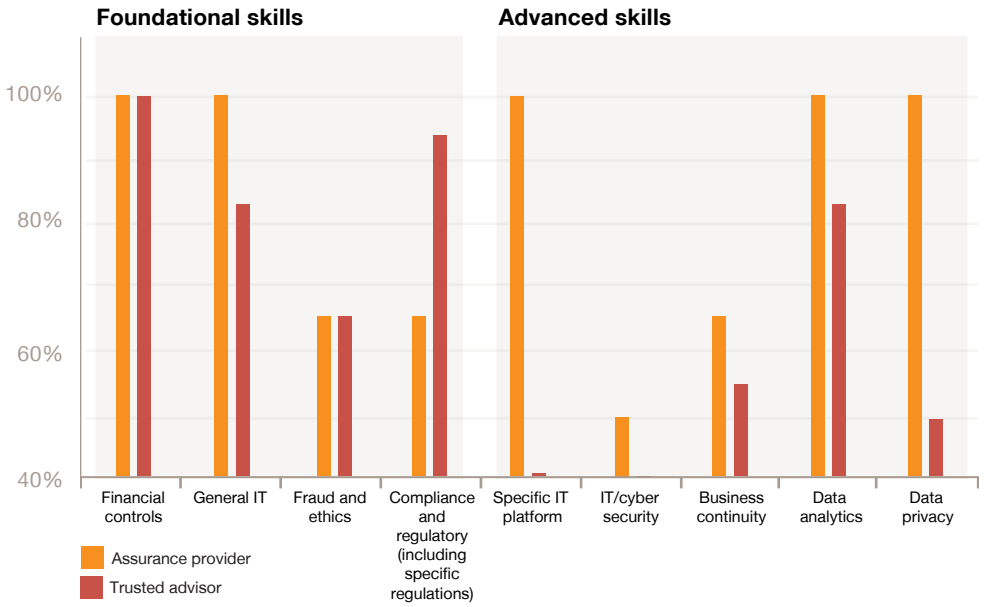


Trusted advisors are performing at a much higher level

Trusted advisors combined performance and value far exceeds assurance providers



Trusted advisors more often possess advanced skills



Percentage of respondents indicating internal audit is performing well

"Ensuring that internal audit's mandate is aligned with organisational objectives and risk is currently dependent largely on the skills of the head of the function and the strength of the audit committee."

—Veronica Du Preez, audit committee member (various organisations) and former CEO, Institute of Internal Auditors, South Africa

Creating the blueprint: Developing an aligned set of expectations

Just as buildings big and small are constructed using detailed blueprints, effective, profitable and well-run companies move forward by design, not default. The expectations of internal audit—just like those of other functions—should be crafted, not patched together in isolation to address immediate needs. It is only when organisations rethink internal audit and align it with the expectations of its multiple stakeholders that the function is able to raise its performance and provide added value to the organisation.

In our interviews, CAEs who believed they were performing well against stakeholder expectations and were highly valued by their organisation attributed the foundation of this success to a well-understood and widely communicated expectation set. Internal audit must be aligned with the expectations of its stakeholders and with the critical risks the organisation faces. These are foundational steps without which the function will be unable to strategically build the right capabilities and raise its performance and value.

Without dialogue and collaboration among board members, senior management, the CAE, and even external stakeholders (e.g., regulators and external auditors), it is very difficult to align expectations. Consider again the huge difference of opinion about whether CAEs should be engaging and managing relationships with stakeholders. Perhaps board members and senior management perceive relationship building to be in conflict with internal audit objectivity. Senior management may also fail to understand the value they could be receiving when such relationships exist. On this particular expectation, our survey shows that those internal audit functions that are most highly valued focus on managing stakeholder relationships. This is not to suggest that CAEs should blindly follow the expectations laid out by their stakeholders. We heard in our interviews that the process of achieving alignment must be led by the CAE, but in collaboration with a variety of internal and external stakeholders, balancing their expectations. While the CAE owns the process, stakeholders should be prepared to contribute to the design process if they want to reap the value internal audit can deliver.

To accomplish this, internal audit and stakeholders needs to be establishing expectations aligned to the eight foundational attributes, while proactively considering current and future needs as well as the increasing expectations of regulators and the second lines of defence, the business units and the risk and compliance functions.

The blueprint components: What goes in the expectation set

Our discussion with stakeholders and CAEs and our survey responses point to the importance of aligning on the eight foundational attributes that comprise an effective internal audit function . Further, CAEs need to develop and gain alignment on the specific expectations of how they are going to successfully deliver on these eight attributes. To develop these more descriptive expectations, CAEs need to engage in dialogue with stakeholders to gain clarity on roles and responsibilities, and further understand those stakeholder expectations regarding scope of services and how they define adding value to the organisation. Given the preponderance of evidence that delivering at the trusted advisor level increases value in the eyes of the stakeholder, the CAE discussion should also focus on whether the stakeholder actually wants internal audit to build these capabilities. If they want this purposeful design for internal audit, a discussion of the timeline to build out these skill sets needs to ensue.

We recognise that all key stakeholders may not agree on the expectations of internal audit and how the function can build the function to deliver on the eight foundational attributes. Therefore, it is important for CAEs to not only gather a variety of perspectives, but reconcile them to establish a common base of expectations on which it can deliver.

The eight foundational attributes of internal audit

Quality and innovation

Quality standards have been defined and cover all of internal audit's activities.

Formal quality reviews are regularly completed to identify improvement opportunities.

Innovation is embedded in the culture of internal audit and is consistently fostered and rewarded.

Business alignment

Expectations are clearly articulated and communicated.

Internal audit defines and articulates its mission and value.

Metrics are developed to measure progress towards the stated mission and vision.

Risk focus

The audit plan is based on both a top-down, strategic approach and bottoms-up approach to identifying business risks.

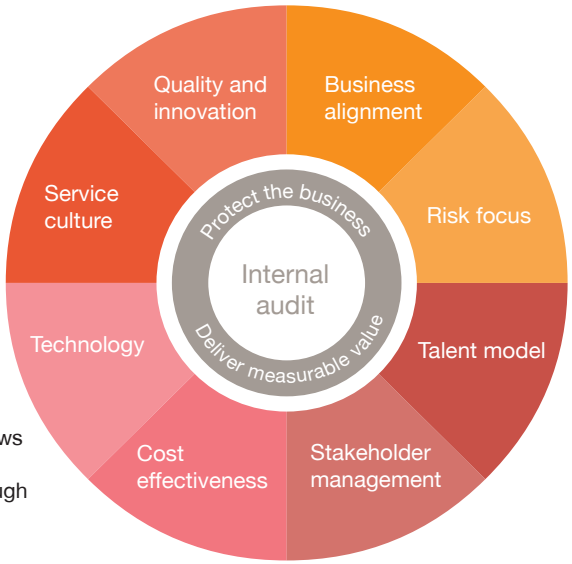
The audit plan is continuously updated to respond to changes in the company and the external business environment.

Appropriate time and effort are spent on assessing the key risks of the enterprise, including emerging and enterprise risks.

Service culture

Metrics measure customer satisfaction based on stakeholder expectation.

All services provide balance of objectivity and value.



Talent model

An appropriate mix of core internal audit and subject matter specialists (including those with significant business acumen) exists to meet required expectations.

A continual learning and development model exists to improve internal audit's knowledge of the business and the related risks, in addition to conflict management and critical thinking.

Staff performance feedback is provided to facilitate growth and development of staff as well as the department.

Technology

Data analytics are deployed, which allows for alignment with business areas while also providing efficiency in testing through automation.

Data is utilised to provide deep and persuasive intelligence on business issues and observations/ recommendations.

Continuous auditing techniques are leveraged to increase audit coverage to provide early warning of risk indicators and increase audit coverage.

Related activities are effectively coordinated through leveraging governance, risk and compliance (GRC) tools.

Cost effectiveness

The staffing model effectively leverages internal and external resources, varying staff levels and geographical locations to efficiently complete audit activities.

Productivity is actively measured and managed to ensure the most cost-effective delivery of services.

Audit methodology and processes are standardised and simplified to be cost effective.

Investments in audit infrastructure are based on a disciplined ROI approach .

Stakeholder management

Stakeholders perceive internal audit as operationally excellent and, where appropriate, as a provider of strategic support.

An internal audit strategic plan exists that captures expectations, communication strategy, and timelines.

Internal audit seeks function-specific feedback regularly, captured though both one-on-one interviews and survey basis.

Internal audit coordinates with the business unit to define expectations and share scope of the audit.

Many CAEs have taken these steps to purposefully design a broader set of expectations that evolve them into trusted advisors. While the journey has not been easy, they consistently attribute their success to alignment and support from stakeholders. Dominique Vincenti, Vice President of Internal Audit of retailer Nordstrom, notes that her expectation set is extremely broad, with internal audit expected to provide a point of view on risk and controls across the organisation, whether strategic, operational, financial, or compliance-related. She also notes that the vast majority of the audit plan and 2014 risk assessment topics are around new technology, execution of new strategic initiatives, and other emerging areas. Although Nordstrom's management does not yet always come to internal audit proactively about these new areas, there is a process to reach alignment with management so that those critical topics become a focus of the audit plan.

Vincenti also admits that getting to the point of being a trusted advisor has not been easy. The management wanted internal audit involved in more areas, and so those areas were added to the expectation set. Vincenti noted that while the board members are in complete alignment, the 'management did not realise what they were signing up for.' As internal audit has increased its scope and started to enter areas that had not been audited before, it initially generated discomfort and required extra effort to create adequate partnership with management and respond to management's legitimate questions about why internal audit is involved.

Nonetheless, she noted that over the past 12 months, internal audit has started to get 'more pull than push,' especially as it has built up its knowledge and expertise and proven its worth on a few highly visible projects. This example highlights that getting to trusted advisor status is a journey, and internal audit needs to broaden expectations in lockstep with the right capabilities to deliver. This may make the journey longer, but agreement on both current and future stakeholder expectations allows the CAE to focus on the critical risks of the organisation and begin to identify the capabilities necessary to increase value and relevance.

Once internal audit and stakeholders explicitly agree on the breadth of what the organisation expects from the function, it is critical that the function stands firm on executing against its scope. Beginning with aligned expectations should reduce pushback. However, there could be instances where conflicts arise. For example, the business may not see value in certain expectations, but the board or regulators do. Further, internal audit may understand leading practices better than its stakeholders, giving the function a more informed perspective on the value it's delivering. Stakeholders may at times have to listen to and trust their CAEs, as long as those CAEs are operating within and towards world-class execution and seeking to define and clearly align expectations. With expectations clearly and collaboratively defined, internal audit should be empowered to manage its resources and activities so that expectations are fulfilled.

Proactively considering future needs and making expectations responsive to change

Over the next 18 months, senior management expects ongoing market changes that will significantly impact their organisations. According to PwC's 2014 *Risk in Review* study, the three biggest areas of business impact include technological change and related IT risks, increasing regulatory complexity, and rapidly changing customer needs and behaviour. To address these shifts, companies continue to adapt their strategies and sometimes drive radical business transformation. Three out of four of our survey respondents say their organisation has undergone a transformation initiative, is doing so, or will in the near future. The combination of market shifts with the business changes undertaken in response is intensifying risk, with 75% of senior management saying that risks are increasing. In the Indian context, 50% of senior management believes that risks are increasing. Internal audit organisations delivering the greatest value have alignment on their role in the current risk environment as well as around emerging risks. As the inter-connectedness of risks and pace of change continue to increase, continually adjusting and gaining alignment on internal audit expectations is critical to obtaining significant value where it matters most.

"Internal audit needs to be able to be in the business conversation and show they understand the business objectives. The function won't have a seat at the table if they don't understand the business and have credibility in management's eyes. Teams need to be transforming and hiring people outside the box. The skill set is totally different today. We used to hire the best accountants. Now we need someone that is as good with communication and able to listen, in addition to having decent technical knowledge. If internal audit thinks their job starts with the balance sheet, they are going to be wrong. Their job starts with the business objectives and where the company is going. If they focus on the business objectives, they will be aligned to the critical risks of the organisation."

Melvin Flowers, Corporate Vice President of Internal Audit, Microsoft, US

According to Richard Chambers, President and CEO of the Institute of Internal Auditors, "Internal audit tends to be very reactionary to the risk *du jour*." A risk *du jour* approach makes it hard for the function to be relevant to the organisation, let alone proactive in aligning skill sets to evaluate how the organisation is mitigating its most critical risks. In our interviews, stakeholders reinforced the notion that internal audit delivers more value when it is aligned to the risks of the company. Sprint's CFO, Joe Euteneuer described internal audit's mandate as "to be proactive in helping us forecast, assess, and manage risk. They are expected to partner with the business as they manage day-to-day operations and be an 'idea tank' for insights around risks and controls for the overall benefit of the company." A well-aligned internal audit function provides value through its ability to bring an objective perspective on managing risk in the areas that matter most to the company.

Aligning with other lines of defence and third parties

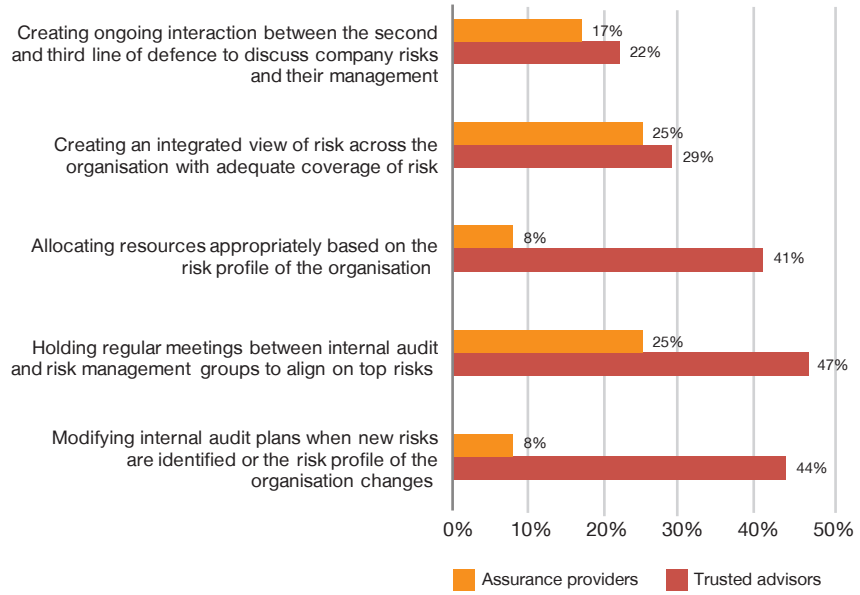
Building construction requires collaboration between many parties outside of the immediate project team, from tenants who will inhabit the building to safety inspectors and community zoning boards. In addition to board members and senior management, we believe that a key stakeholder of internal audit is the second line of defence, which includes the enterprise's risk management oversight function, and hence it is critical for internal audit to achieve alignment with that line of defence. To further understand the difference in how assurance providers and trusted advisors interact with the other lines of defence, we evaluated the tactics that each group uses.

As demonstrated leaders in optimising value for stakeholders, trusted advisors routinely employ certain tactics at a much higher percentage than their assurance provider counterparts. In fact, for virtually all of the areas on which we surveyed, trusted advisors use of these tactics is double that of assurance providers. From our *Risk in Review* research, we are continuing to see a gradual maturing of enterprise risk management oversight functions. As these functions mature, all internal audit groups can take some lessons from the trusted advisors and start developing plans to deploy these tactics for interacting more collaboratively with the second line of defence. Simple steps that can be taken, regardless of the maturity of the organisation's enterprise risk management function, include beginning to use common definitions of enterprise risks, gaining clarity of expectations regarding the roles and responsibilities of the second line of defence versus internal audit's roles and responsibilities as the third line, and then designing a plan to collaborate on an ongoing basis.

"From a big-picture perspective, regulators take a risk-based approach to regulatory oversight. Part of our assessment of the risk profile of an organisation is the effectiveness of risk management and the control environment. Internal audit is a critical third line of defence, so the effectiveness of this function directly impacts our perception about the risk profile of the organisation and the commitment of senior management and the board to effective risk governance."

—Carlo di Florio, Executive Vice President, Risk and Strategy, FINRA, US

Tactics used to align internal audit with other lines of defence



Percentage of respondents who use this tactic routinely

"Internal audit needs to have the respect of the business to be effective. To be respected, you need to have the right attitude in internal audit. We have put together a rotation plan that brings top talent into internal audit from the business and from outside the organisation. This helps develop broader business knowledge in internal audit and also continues to help us expand our control skills and corporate values in the business. We also co-source to supplement internal audit resources. This provides a consistent presence that complements the rotation programme and offers coverage where we don't have people or the specialised skill set required for a particular situation."

—Jeremy Smeltser, CFO, SPX, USA

Third-party expectations of internal audit should be considered as well. This year, in addition to interviewing stakeholders and CAEs for this report, PwC spoke with senior leaders at certain regulatory agencies to get their 'outside in' perspective on the influence regulatory expectations are having on internal audit. In general, we found that regardless of whether they are operating in traditionally regulated sectors (e.g., financial services, healthcare) or are regulating across multiple sectors, regulators agreed that internal audit should demonstrate the eight foundational attributes. From our discussions, it was clear that regulators plan to place even more reliance on internal audit, leading them to emphasise the need for internal audit to be involved in emerging risk and other areas of change. The regulators also emphasised the need to include more technical resources on the team and to establish more effective lines of communication with all key constituents throughout the enterprise. Finally, regulators also stressed the importance of internal audit taking advantage of its unique position of having a macro-enterprise point of view across lines of business and functions and of being involved in critical initiatives while maintaining its wall of objectivity.

Our interviews and PwC's experience indicate that regulators are expecting more from internal audit. However, according to this year's survey, these expectations are not translating into significant influence over internal audit areas of focus. When asked about the extent to which regulatory expectations were impacting internal audit, most respondents did not think such impacts were significant. That said, board members believe the influence of regulators on internal audit is much greater than CAEs believe it to be. This lack of alignment on regulator influence serves as evidence that more consideration of the applicable regulators' expectations could be warranted.

While many are not seeing significant regulator impact, our survey data and interviews showed that internal audit groups are taking varied approaches to addressing regulator expectations. Across survey respondents, 29% have added headcount as a result of regulatory expectations, while 40% have increased use of third parties to gain the necessary skill sets. Nordstrom's initial approach to address the increases in regulatory expectations has been to quickly increase the number of resources, with the intention of 'right-sizing' resourcing once skills are built up. As part of this ramp-up, Nordstrom is rethinking the types of skills it needs from operational auditors to address regulatory compliance. For example, Nordstrom has hired lawyers into internal audit and is training them to become auditors. Company Vice President of Internal Audit, Dominique Vincenti commented, "They are well-tuned and able to understand regulatory rulings, and it has worked really well. It builds good credibility with management and, in particular, with the regulating body examiners, that someone understands the legal rules at an expert level as well as their implication."

According to a Fortune 50 Chief Compliance Officer, in an effort to more proactively manage the broad scale of complex global compliance risks facing the organisation, the compliance function turned to internal audit to support its compliance auditing programme. In turn, internal audit, leveraging its co-source provider for subject matter expertise, created a compliance audit group whose sole focus is executing compliance audits to measure adherence to global compliance policies in support of the Chief Compliance Officer's compliance monitoring programme.

While each industry has its own regulatory influences, board members, senior management, and CAEs should understand the specific expectations of their regulators and, if appropriate, design their expectations accordingly. To effectively manage change and complexity and keep their organisations in compliance, CAEs should be expected to regularly reassess applicable regulatory requirements.

"We have created local audit offices in new markets (Shanghai and Sao Paulo). This allowed internal audit to be closer to local business units, acquire knowledge of local context, and develop talents regionally, while trying to maintain consistency in the audit approach among all audit teams globally. Staffing of engagements remains global—ensuring approaches are consistent."

—Valerie Moumdjian, CAE, Solvay, Belgium

Preparing to build: Crafting the capabilities to deliver on expectations

Achieving alignment on the breadth of expectations and critical risks is a significant step toward internal audit improving its relevance and value to the business. However, continued, measured, strong performance on these newly aligned expectations is what ultimately increases internal audit's value and provides the opportunity for internal audit to expand its expectation set. This can only be accomplished through innovative solutions and expanded capabilities.

Choosing the right building materials

For many internal audit groups, high-quality performance on expectations requires continual investment in new, innovative solutions. Google CAE, Lisa Lee reported that, "As a technology company, we need to continue to innovate and adapt for a changing environment. This has led to internal audit focussing more time on consulting-type engagements or up-front advisory services to think about upside and downside risk. This is done in lockstep with management to help them think about controls and risk throughout the process, even if the end product is not yet defined. As we continue to spend more time in the forward-looking audits, where management is finding the most value from internal audit, there is a need to find the balance to also do more traditional transactional assurance audits or backward-looking audits. We have begun to look at leveraging data analytics to supplement the backward-looking audits to free up more time for forward-looking audits."

Over the past few years, the Bank of the West internal audit has changed its report format significantly to be more focussed on control gaps and root causes instead of exceptions. According to David Fong, Bank of the West's Professional Practices Audit Director, "The challenge with this has been training up tenured auditors to think differently about audits and audit testing." To address this challenge, internal audit has expanded staffing with experienced directors who can challenge and build up skill sets within functional areas. Fong believes that "in order to get a seat at the table within the organisation, you have to earn it. This will be done by putting the right person in to do the audit that can bring perspective around control gaps and root causes."

Leading organisations are demonstrating that internal audit can continue to take performance to the next level by employing continuous improvement methodologies such as six sigma. Progressive Corporation recently hired a six sigma–trained black belt as an audit manager with the specific intention of improving internal audit performance. They use only the aspects of six sigma that are relevant for internal audit, applying the concepts that make sense for their environment. While initially skeptical, the audit team has seen the benefits. Auditors now have a better process understanding and a relentless focus on process improvement and root cause analysis, and they support findings with data and statistical analysis. Adopting six sigma methodologies has helped internal audit improve its understanding of how processes are controlled, and has also improved collaboration between auditors and auditees, driving better buy-in on findings and recommendations for improvement.

The most critical building material: Skill sets

Internal audit functions create value through high-quality performance, which is enabled by having the right capabilities to meet the organisation where it is today and stay ahead of where it is heading in the future.

Establishing more robust expectations, fully aligned with stakeholders, gives internal audit a framework against which to assess its current capabilities and identify gaps. While virtually all internal audit functions evaluate the need for headcount annually, they do not always evaluate their current and future resource needs against the specific skill sets that align to stakeholder expectations.

A gap assessment of this nature may lead to a very different talent model than internal audit has historically employed. Once this skill set assessment is completed, a thoughtful, well-designed plan to obtain the right skill sets can be put into place.

Stakeholders of trusted advisor internal audit functions believe internal audit has to expand its skills well beyond financial controls, fraud and ethics, and general IT to encompass areas of critical business risk such as cyber-security, business continuity, data privacy and security, and specific IT platforms. For example, stakeholders of trusted advisors are 22% more likely than stakeholders of assurance providers (70% vs 48%) to believe internal audit has skills related to specific IT platforms (e.g., SAP, Oracle, PeopleSoft). Stakeholders of trusted advisors in India are far more optimistic with all respondents believing that internal audit has skills related to specific IT platforms as compared to just 12.5% of the assurance provider stakeholders. A similar difference can be seen in the areas of data privacy

and business continuity skills, where more than 80% of trusted advisors say internal audit has these skills, versus just 56% of stakeholders of assurance providers. For the Indian scenario, 67% of trusted advisors and 56% of assurance providers believe that internal audit has business continuity skills. While for data privacy, all trusted advisors respondents and 50% of assurance providers believe that internal audit has this skill set. Trusted advisors did not attain these skills by default, rather they purposefully designed a plan to obtain the skill sets that were most valued by their respective organisations, whether by recruiting different skills from within their company or by leveraging sourcing relationships.

In our survey and interviews, CAEs cite problems with increased turnover and a lack of specific subject-matter specialist skills, yet they also state that having people with skills aligned to the risks of the organisation is a critical building block to an effective function. Diving deeper on this point, the majority of these same CAEs also report that they will not be adding resources in the next 12 months, and will instead try to do more with the resources they already have. Based on our survey results, this approach has been noticed by stakeholders, as fewer than half (49% and 58% for India) of senior management believe that internal audit is performing well at obtaining, training, and/or sourcing the right level of talent and the right specialists for its needs. As the right talent model is imperative to delivering on expectations, it is no wonder that there is such a correlation between stakeholders' views about internal audit's skill set development and their views about its overall performance. As CAEs take charge of building a function by design, they must address skill-set needs head-on with stakeholders. Stakeholders, for their part, must be open to the conversation and supportive of the potential investments or changes that may be needed.

Internal audit functions that continually evaluate resources and skills against a defined set of expectations get the support from stakeholders to invest accordingly and are able to deliver quality services that are relevant to their organisations. As any company expands or changes, leaders in all areas of the business take proactive steps to keep pace with those changes. This proactive approach should be no different for internal audit, regardless of whether it is delivering on foundational or more strategic expectations.

Many internal audit functions are finding that they can only deliver on expectations by leveraging subject-matter experts to fill the gap in skill sets on a near-term basis—a strategy that, in many organisations, requires a new way of thinking about how to source talent and develop resources. Several CAEs we spoke with indicated that they are turning to co-sourcing to bring in the necessary skills missing in the function. Educational Testing Service is one company that has taken action to address both its skill set and staffing approach. CFO Jack Hayon said it well, "In this day and age, a small, static internal audit group cannot bring the skills that are needed to manage the complex risks companies face, understanding FCPA, IT security, data, PII, international risks, and more. Such groups tend to do the audits they're comfortable doing. If they move outside of traditional areas, they sometimes find they don't have the skills or approach to deliver. Such small internal audit shops with limited skills may be a disservice to a company." Hayon indicates that by leveraging a co-source arrangement, internal audit was able to demonstrate it could add value on a broader expectation set by bringing the right skills when needed. According to Hayon, it has delivered value routinely, and now, when there is an issue, management asks for internal audit involvement.

To meet expectations, many CAEs are seeking further clarity from their stakeholders on how to develop the right talent model. In our research, we continued to hear about formal rotation and guest auditor programmes, extending recruiting efforts beyond traditional financial accounting or external audit experience, co-sourcing to gain access to better methodologies and skill sets, and, where warranted, full outsourcing of the function. As Caterpillar Inc CAE, Amy Campbell told us, "Co-sourcing has brought the audit subject-matter expertise where and when we need it. Combining this with our in-house business expertise has been essential in our ability to deliver on our stakeholder expectations."

"We expect internal audit to highlight good practices and areas of opportunity per the latest regulatory requirements. We ask internal audit to provide views and insights on anticipated regulatory changes, the impact of these changes on our operations, and our preparedness for them."

—Raman SK, COO and board member (Finance Head), Kemwell Biopharma, India

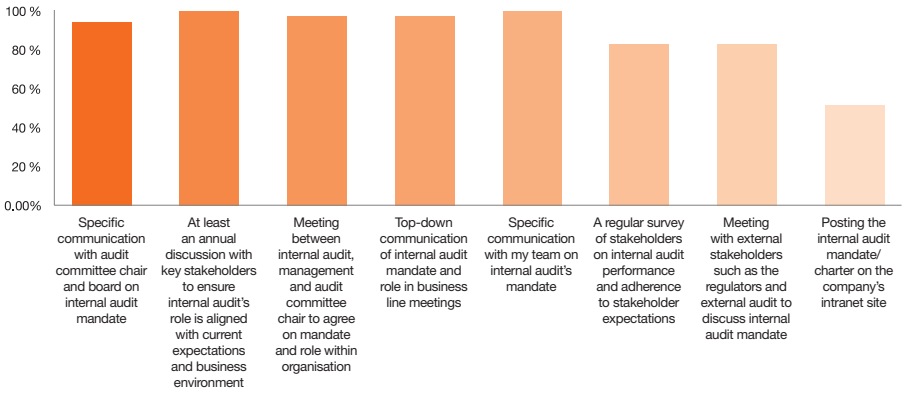
Sharing the blueprint: Internal audit's communication strategy

A comprehensive communication plan is a critical component of internal audit being able to stay the course against its defined expectation set. Leading internal audit functions create a communications strategy that spans all stakeholders in order to gain and sustain consensus on expectations and the capabilities required to deliver on expectations.

CAEs that are considered trusted advisors to their organisations employ multiple tactics in their communication strategy. Among these CAEs, the approaches considered most important all involved discussion between the CAE, senior management, the audit committee chair, and other stakeholders regarding internal audit's mandate, its role within the organisation, and the expectations on which it needs to deliver,including at least annual discussion to assure internal audit remains aligned on expectations, taking into account the organisation's changing needs and changes in the business environment.

Interview participants also offered their own approaches that have consistently helped them to communicate expectations and performance. Some of these include regular participation in integrated working groups with stakeholders, quarterly meetings with business unit management, utilisation of experienced business resources within the internal audit function, and one-on-one discussion with operational management.

Communications tactics used by leading internal audit functions
(Percentage of trusted advisor CAEs indicating tactic is important or very important)



"The team's innovation into data analytics has been the biggest visible change to our approach at Australia Post. It has improved the value we deliver significantly and allows the team to audit key processes regularly and efficiently. In a number of cases, we have handed over testing activities to the business to help them manage their risks in real-time. Thanks to data analytics, we are now performing more audits and providing greater comfort."

—Greg Evans, General Manager, Internal Audit, Australia Post, Australia

As Sprint's CAE, Karen Begelfer told us that communicating internal audit's mandate is a continuous process. She believes that alignment on internal audit's role is due to a strong information-sharing process by internal audit across the company, and noted that her team 'pounds the pavement by getting out and talking to as many people as we can. Begelfer meets with the CEO's direct reports once per quarter to discuss initiatives, risks, and trends. Internal audit managers meet with their peer stakeholders once per quarter as well.

Regular communication of expectations and responsibilities with stakeholders allows the CAE to set the foundation. Just as a builder is responsible for executing the construction based on the blueprints and reporting on progress to stakeholders, internal audit should monitor, track, and report performance and value against stakeholder expectations. Performance and value monitoring and reporting enables stakeholders to see what internal audit is doing well and provides feedback to internal audit on where value is perceived and where performance gaps may exist. For those internal audit functions tackling performance gaps, a performance improvement plan should be developed, close and frequent monitoring against that plan should occur, and milestones to improve performance should also be put in place.

Ways that internal audit is communicating its value

- Involvement and value provided in all key initiatives and emerging risks, including new systems, acquisitions, dispositions, new products, new regulations, etc.
- Ability of internal audit to provide macro/horizontal views on key issues and areas of critical risk to the organisation
- Ability of internal audit to be a 'change agent' in the organisation, exercising influence that improves the overall control environment year over year
- Annual 'voice of the customer' survey
- Ability of internal audit to answer questions from the board and management
- Value of recommendations provided
- Cost savings and revenue enhancement based on internal audit recommendations and findings

"Given our unique perspective on the company, internal audit has a tremendous opportunity to be a change agent. Through monthly and quarterly meetings, we stay abreast of what is happening across the company and the industry and provide real-time observations and recommendations regarding key initiatives, decisions, and processes."

—Michael Jenkins, Vice President Internal Audit, The Gap, US

Our survey results show that internal audit functions that operate at the assurance provider level more often report classic value measures to stakeholders such as successful completion of the audit plan and coverage. In contrast, trusted advisors are focussed on communicating the value they bring to the organisation through the recommendations they provide and their involvement in emerging issues. Our interviews also identified several internal audit functions that are tracking and communicating the influence that they've had on changing the control environment to better the organisation.

What this means for your business

Actions to be taken

When building anything of substance and value, whether a world-class skyscraper or a world-class audit organisation, the builder needs input from others: an owner who sets the vision, clients who describe their needs, workers with the capabilities to meet those needs and exceed expectations, and inspectors to advise on quality and safety throughout the various stages of completion. Though responsibility ultimately rests with the builder, the construction process is a group effort. Without alignment on expectations, investment in capabilities to deliver, and a well-designed communication plan, internal audit cannot achieve optimal performance and deliver real, measurable, and appreciated value.

Our research indicates that CAEs that are given the opportunity and the resources to deliver against more strategic expectations are more relevant to their organisations, and stakeholders report receiving greater value from internal audit. The vast majority of CAEs are doing what they can to construct a function that delivers value, but many are doing so with resources and processes that may not be aligned to their stakeholders' expectations. Through purposeful action, trusted advisors broadly communicate their expectations and the results achieved, and they insist on matching their resources to deliver on stakeholder expectations.

The CAE must purposefully design his or her internal audit function by leading on collaboration and gaining consensus on stakeholder expectations. However, given the complex and changing risk environment facing most organisations, senior management and board members should also have an active voice in the design of the function, be supportive of the potential need for investments in skill sets, and encourage internal audit to focus on delivering value to the organisation.

To accomplish this, we offer specific actions.

Chief audit executives: Lead the design and communication plan

- Lead by developing a point of view on what your stakeholders expect of internal audit and how you are fulfilling these expectations. The level of detail included in this expectation set should be more granular than what's included in the internal audit charter, and could potentially include responsibilities that go beyond the more traditional internal audit areas. Our research continues to show that purposefully designed functions focussed on what matters most to stakeholders are delivering more value.
- Lead by using an aligned set of expectations to assess needed skill sets against your current capabilities and to develop an action plan, including milestones and metrics to address any capability gaps. Gain support from stakeholders to invest in resources as needed, or revise expectations to what can be achieved with the resources available to you.
- Lead by creating a communication plan to purposefully gain alignment on the suggested inventory of expectations. We recognise that each stakeholder may have different objectives and expectations of internal audit. Complete alignment may not be achieved, but the blueprint of what internal audit plans to execute on should be clearly communicated back to all stakeholders.
- Lead the effort to regularly reevaluate the design and approach of the function to keep it aligned with stakeholder expectations. This is often done through regular monitoring of performance against expectations and execution of a communication plan to validate with stakeholders the value you are delivering.

Board members: Provide proactive input and approval of the design

- Provide input on the board's expectations, with an understanding of leading practices and the value internal audit could deliver if expectations, supported by capabilities, are more strategic in nature and better aligned with the most critical risks of the organisation.
- Provide input to senior management on your expectations of internal audit, and encourage them to provide guidance to the CAE to facilitate alignment on expectations.
- Provide input on how you expect internal audit to achieve its short as well as long-term strategic plans, including the need to invest in skill sets and processes to deliver on your expectations.
- Provide input on when and how the CAE should communicate with you. In most organisations, the CAE reports directly to the board, but has an executive to whom they are also accountable. Acknowledge the healthy governance this structure creates, encourage the CAE to have regular (more frequently than quarterly) communications with you, and support them by removing barriers to making this dialogue productive.

- Provide input to the CAE on how and when you would prefer internal audit report progress against expectations. Do not settle for 'on-time, on-budget' type reporting. You should expect more and internal audit should be delivering more.
- Provide approval from audit committee on agreed-upon design

Executive management: Support the design

- Support the design by clearly communicating expectations and working collaboratively to reach an aligned set of expectations, recognising that not all management expectations will make it into the final blueprint.
- Support the idea of involving internal audit in non-traditional areas, and value the new perspectives and feedback the function can bring. Embrace the concept that internal audit capabilities have evolved, and that, if properly aligned and resourced, it's capable of delivering on broader, more strategic initiatives and producing significant value. We recognise this effort can be difficult and sometimes uncomfortable, but our research clearly indicates that when internal audit journeys toward trusted advisor status, stakeholders receive great value.
- Support the efforts to align skill sets with your business risks and the aligned expectation set. We understand cost pressures exist and are not advocating rote or complete approval of all new investments. We encourage you to engage in a dialogue around skill set gaps and the alignment to your expectations, rather than limiting discussion to traditional areas such as full-time equivalent headcount.
- Support the need for ongoing communication and encourage the CAE to have regular dialogue with board members and various members of senior management.
- Support internal audit's efforts to develop metrics that align to your expectations, and expect more than the typical report on controls. Trusted advisor functions are progressive in the metrics they monitor. Consider if your internal audit function could improve its scorecard, and hold it accountable.
- In today's business environment, the velocity of change is too fast to continue to try and do more with the same approach and the same resources. As our survey and experience have shown, aligning expectations of internal audit, having candid discussions around the value it can bring, and talking frankly about the capabilities it needs to do so will consistently result in internal audit functions that are highly valued by their organisations.
- Business units adjust sales targets for the sales group each year. Manufacturing sets annual goals for improving yield and productivity. Just like other functions striving to be world-class, internal audit should continue to evolve with the organisation through a purposeful strategy, aligning on stakeholder expectations that themselves are continually evolving with the business. Meeting these changing expectations through continually evolving and expanding capabilities, instead of reacting to change after it has occurred, will enable internal audit to become and remain more relevant, no matter what strategies and directions the business pursues.

Are you creating high performance by design?

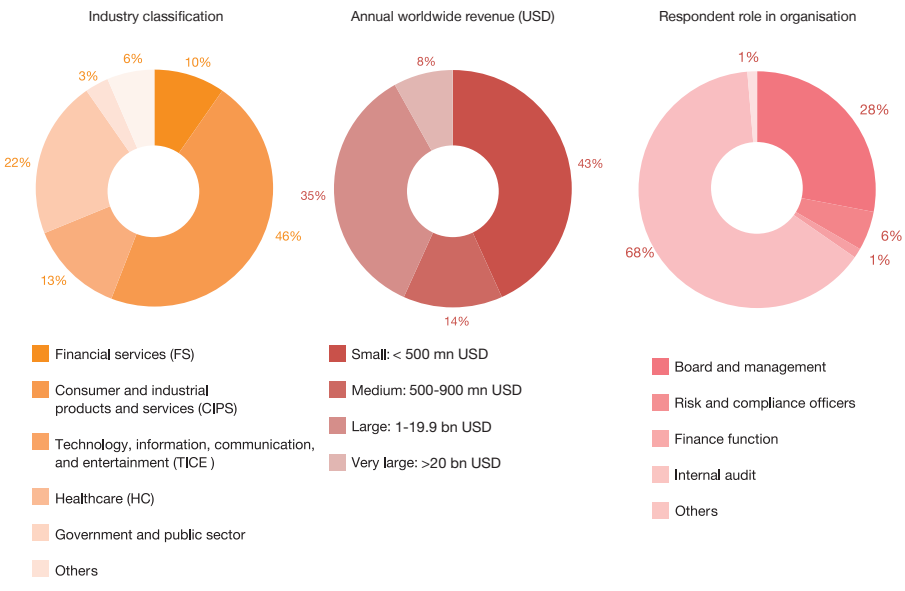
Appendix A: About the research

The *2014 State of the Internal Audit Profession Study* combines qualitative as well as quantitative research. An online survey was fielded in the fall of 2013, generating responses from 1,920 executives. The majority of respondents were chief audit executives and their direct reports, with the remainder encompassing audit committee chairs and other board members, CEOs, CFOs, chief risk officers, compliance officers, and general counsel. These participants represented companies across a range of company sizes and industries, with 24 industries and 37 countries represented in the respondent base.

To gather qualitative data on perspectives and leading practices, PwC also conducted one-on-one interviews with more than 125 stakeholders and CAEs across North America, Europe, Australia, and Asia. To further develop our qualitative perspectives, we leveraged our experience in performing internal audit services for a number of clients across a broad range of financial sizes, industries, and geographic sectors. We would like to thank all of the executives who gave their time to provide added insight to this year's study. Their perspectives are extremely helpful and greatly appreciated.

Within this report, we refer to a subset of respondents as trusted advisors. This group comprises 24% of the survey sample, with balanced representation of industry, geography, and company size. This grouping represents those respondents who indicated the definition of the value they receive from internal audit best matched the following description: 'Internal audit provides value-added services and proactive strategic advice to the business well beyond the effective and efficient execution of the audit plan.' Similarly, the group referred to as assurance providers in our study (representing 13% of respondents) selected the definition 'executes effectively and efficiently on audit plan and communicates findings accordingly' as the best match for the value they receive from internal audit.

Respondent demographics



Appendix B: Critical risks

Risks are rising across the board, a trend acknowledged by three out of four survey respondents (75%) and carried over from last year's survey, when 81% of respondents indicated the same. The Indian figures are also similar with 71% respondents agreeing that risks are on the rise. While news headlines focus on economic recovery and moves toward fiscal austerity in many parts of the world, top executives' attention has shifted: in all, only 42% (similar case for India as well) of respondents ranked global economic shifts and uncertainty as major drivers of change over the next 18 months. Instead, respondents expect the most impactful driver of change to their organisation over the next 18 months to be technological change and IT risks (58%). While for India, changing customer needs and behaviour stands out to be the most important area for change.

In response to this and other powerful market shifts, organisations in all sectors are undertaking dramatic business transformations. Indeed, when asked to rank the biggest internal drivers of change over the next 18 months, 71% of survey respondents pointed to business transformation (69% for India). Following business transformation are other, closely related internal change drivers: growing reliance on technology and IT systems, innovation around products, services, and business models, and changes in talent, staffing, and resources.

Biggest drivers of change over the next 18 months

In your view, which of the following external drivers of change will have the biggest impact over the next 18 months on your organisation?	
Technological change and IT risks	58%
Increasing regulatory complexity and scrutiny	56%
Changing customer needs and behaviours	50%
Government policy changes (fiscal and monetary policy, etc)	42%
Global economic shifts and uncertainty	42%

In your view, which of the following internal drivers of change will have the biggest impact over the next 18 months on your organisation?	
Business transformation / change management initiatives	71%
Growing reliance on technology and IT systems	59%
Innovation around products, services, and business models	52%
Changes in talent, staffing, and resources	38%
Mergers, acquisitions, and divestitures	32%

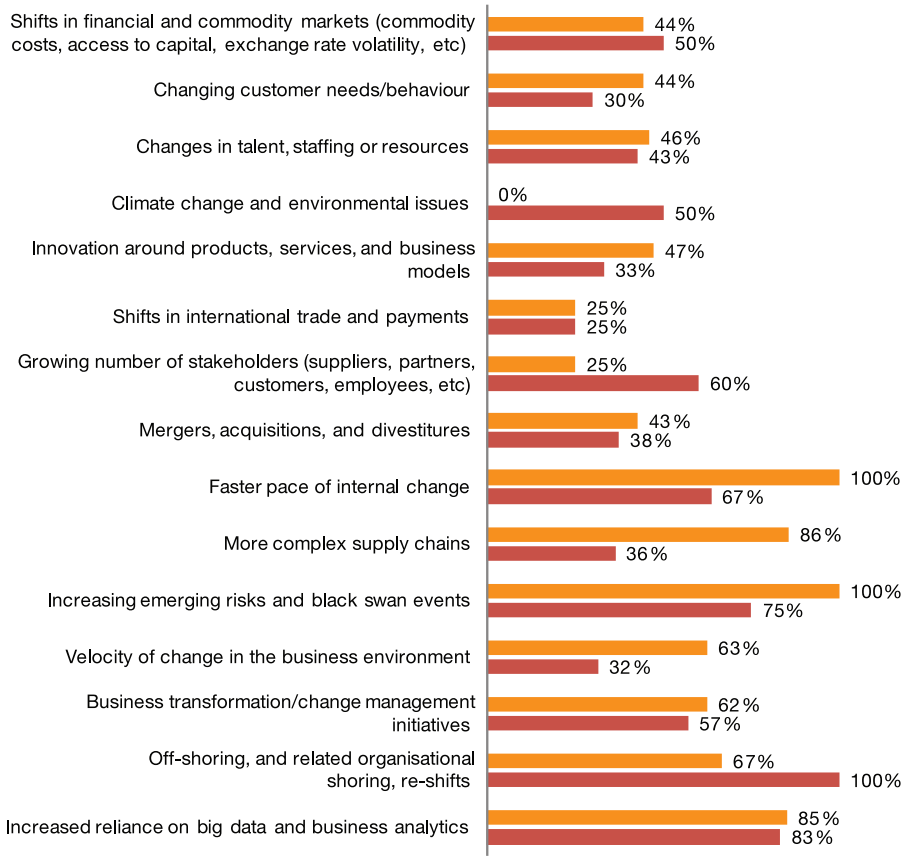
As organisations identify their capability gaps relative to these changes, internal audit must be aligned with the critical risks organisations face and the expectations on their function relative to those risks. Our *State of the Internal Audit Profession survey* results show that organisations that expect internal audit to be a trusted advisor want internal audit involved in critical risks.

For example, 80% of respondents expect trusted advisors to be more involved in the company's increased reliance on big data and business analytics in the next 12 months while for India it is slightly higher at 83.3%. In all risk areas, trusted advisors are more likely to be involved than assurance providers.

Finally, our survey results show that those enterprises with internal audit functions operating at a trusted advisor level also tend to have more mature risk management capabilities. Those enterprises with mature risk management capabilities manage risk well more often (96% for global and 92% for India) relative to those that are in the early stage of risk management capabilities (36% for global and 50% for India). Thus, the maturity and depth of the organisation's risk management and internal audit functions in helping to manage risk are both of paramount importance as organisation's wrestle with an increasingly complex global risk environment.

Focussing on critical risks and issues is a foundational internal audit attribute. When developing its draft expectation set, internal audit should explicitly discuss with stakeholders their expectations of internal audit's role in addressing critical risks. Stakeholders should understand the value internal audit could deliver against critical risks and support internal audit's investment in the capabilities to provide value where it is needed most. Ultimately, with strong coordination and clear role definition across the three lines of defence, organisations are in a position to best defend against a dynamic, evolving risk landscape.

Areas in which respondents want greater internal audit involvement over the next 12 months



Percentage of respondents indicating that internal audit should be more involved over next 12 months

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