



GLOBAL PERSPECTIVES AND INSIGHTS

Internal Audit in the Age of Disruption



Advisory Council

Nur Hayati Baharuddin, CIA, CCSA,
CFSA, CGAP, CRMA –
Member of IIA–Malaysia

Lesedi Lesetedi, CIA, QIAL – *African
Federation of Institutes of Internal
Auditors*

Hans Nieuwlands, CIA, CCSA, CGAP –
IIA–Netherlands

Karem Obeid, CIA, CCSA, CRMA –
Member of IIA–*United Arab Emirates*

Carolyn Saint, CIA, CRMA, CPA –
IIA–North America

Ana Cristina Zambrano Preciado,
CIA, CCSA, CRMA – *IIA–Colombia*

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Introduction

Disruption is sometimes described as a wave, crashing upon established business practices; or as an earthquake, upending the stable ground upon which the organization has stayed solid for years.

Neither metaphor is quite right. Disruption is more like a herd of horses galloping toward you. Sometimes you can see the herd coming, other times it catches you by surprise. With enough skill and preparation, the organization *can* climb astride the herd, harness its strength, and go in a new direction.

Or you can do nothing and get flattened.

The great challenge for internal audit executives today is to perceive disruptions in their true form. Recognizing what's coming and providing insight to the organization on how to harness that disruptive power is truly valuable. This is nothing new for internal audit. Insight is core to the Mission of Internal Audit — to enhance and protect organizational value by providing risk-based and objective assurance, advice, and insight.

“Disruption does sometimes come quickly, and catches us all by surprise,” says Carolyn Saint, chief audit executive (CAE), University of Virginia. “But we should also be honest, that many times you can see a disruption coming from miles away. A real, formidable challenge is how to explain the implications of a coming disruption to business leaders, so the organization can respond.”

Examples of slow-rolling disruption are many, and usually they involve “the rise” of something: of the internet in the 1990s, of China as an economic power in the 2000s, of cloud computing in the 2010s. Audit executives can take their pick of possible disruptions for the 2020s: self-driving cars, artificial intelligence (AI), the Internet of Things (IoT), protectionist trade policies — and, most likely, many more.

The forces that propel disruption include *technology* (advances in wireless communication, GPS satellites, and so forth); *policy* (the advent of free trade after World War II, and its possible retreat today); *demographics* (baby booms that shift political moods, or ageing populations that trim economic dynamism). And sometimes random events shake standard business environments to the core (the Sept. 11, 2001 attacks, the financial crisis of 2008, the Spanish flu epidemic of 1918).

“A key point about business disruption is that you can't control it, per se,” says Lesedi Lesetedi, deputy executive director (deputy CEO) — Strategy & Corporate Services, Botswana College of Distance & Open Learning (BOCODOL). “No single company can ‘stop’ digital disruption or prevent some new business model everyone else in the world loves. At best, a perceptive CAE should see the opportunities and risks that a disruptive force creates, and help the board

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For example, consider a hypothetical long-time manufacturer of farm equipment that wants to embrace the IoT. Fitting every harvester, tractor, and irrigation system with internet sensors will be easy. Connecting them to a wireless network will be easy. Reporting all the collected data back to a central computer will be easy.

Then what?

That manufacturer will soon need to offer software applications to help customers analyze the data. It will need to embrace AI that can help its farming customers wring maximum efficiency out of their equipment. It will need to address risks of data security and become cyber resilient. It will need to ponder questions of interoperability, if a customer wants to integrate its own sensor onto a separate piece of equipment and then integrate it into the rest of the system.

In short, at some point the manufacturer of farm equipment will have a choice: to keep making equipment, or to branch into “agricultural data management” or some such new field enabled by IoT. And if it chooses the latter, more lucrative path — why not outsource the equipment manufacturing operation altogether? (See China, above, rise as an economic powerhouse.)

That is a possible disruption, and it’s not far-fetched; it’s a modern-day version of the same choice IBM faced 25 years ago: manufacture terminals, or embrace IT services? IBM chose services.

Ultimately, of course, the manufacturer’s board would answer that IoT-enabled strategic question. The CAE’s job is first to help the board see that such questions are emerging, and to understand the risks and opportunities once the company embraces (or even just tiptoes toward) a disruption.

Finding Internal Audit’s ‘Value-Add’

CAEs want to serve in the role of trusted advisor. Boards and senior managers say they want that, too. The question is whether CAEs actually *are* living up to that role, especially as the business landscape sees more disruption.

For example, in [PwC’s 2017 State of Internal Audit survey](#), 68 percent of board members and 77 percent of management believe their internal audit function isn’t doing enough to help manage disruption. More than half believe internal audit lacks the subject matter expertise to manage disruption; 38 percent say internal audit lacks sufficient resources to be useful.

“It’s a chicken-versus-egg challenge,” says Ana Cristina Zambrano Preciado, president, IIA–Colombia. “If the audit function is bogged down with immediate



compliance concerns, the CAE can't necessarily devote enough time to pondering disruption and becoming a trusted advisor. But if you can't add much value when the board debates strategy and disruption, from their perspective, why would they let you occupy a seat at the table?"

On a straightforward level, one way to escape that trap is to improve the work of the internal audit function. For example, an internal audit department could embrace innovation by working smarter with data analytics and robotics. Using robotic process automation, internal audit could develop software tools that enable the first lines of defense to analyze an entire universe of data, rather than a small sample. In this way, internal audit becomes a source of disruption, providing the first line of defense with a way to automate its risk management activities. That, at least, gives a CAE more time to think strategically about business risks.

"Time is your most important resource. If immediate needs keep pulling you away from that strategic analysis you want to do, you're sunk," says Hans Nieuwlands, CEO, IIA-Netherlands. "So first you need to make your audit department work strategically, for example with better analytics and smarter use of technology. Then you can start lifting up your head to look at the horizon, to see what disruptions are coming."

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Anna Cristina Zambrano,
IIA-Colombia

Get There on Time

A principal challenge of disruption today — one that didn't exist for prior generations — is how quickly and easily it can emerge. Blame advances in digital technology.

That is, 100 years ago, the automobile was indeed a disruption to the railroad industry. But the auto industry needed huge amounts of capital, manpower, and time to establish itself.

Digital disruption is wholly different. Consider this point from Max Wessell, a lecturer at the Stanford School of Business and general manager of venture capital firm SAP.iO, [who recently wrote in *Harvard Business Review*](#):

In today's world the most pointed disruptive threats look different. They are not asset-heavy. They are asset-light. And while that may seem appealing to unsavvy onlookers, it can be the kiss of death for a CEO facing disruptive entrants.

Why? Asset-light businesses are not financed with debt. They're financed with equity. That's a resource that is much less expensive for new businesses with no track record than for established businesses with all the credibility in the world.

Wessell was writing for CEOs and CFOs worried about nimble competitors rushing over the horizon, but his point is just as valid for CAEs. *Disruption*

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happens more quickly today because disruption has never been easier and cheaper to do.

Given that fact, another best practice for CAEs becomes clear: work more closely with the business units, since they are a prime source of disruption. Whenever possible, be present at the moment of creation.

Nur Hayati Baharuddin, member, IIA–Malaysia, says that close contact with business units is, ultimately, a crucial part of the CAE’s job.

“What the board doesn’t want, ever, is a business process that gets beyond its control,” she says. “How does the audit function provide assurance that doesn’t happen? By assessing the risks of the process, and determining whether controls are designed and working properly. That’s what we do. Well, disruption *can* be just another business process if you govern it smartly, and that’s where the CAE enters the picture.”

That is not necessarily easy to do with business disruption. But remember: disruption supplants one set of business practices with another. Those new practices, as surprising as they may be at the start, *will* evolve into a business model. So what types of models might emerge? What risks — operational, financial, compliance, reputational — would they bring? Those questions, a more open-ended form of risk assessment, are what CAEs should ask.

From the answers, says Karem Toufic Obeid, CAE, Tawazun, a board can begin to establish its appetite (or lack thereof) for those risks. And then a CAE can take that direction back to the business unit, and begin to build new controls and monitoring tools for the new model of business.

“It’s a bit like learning to drive when you’re 17 years old, but with the judgment you have when you’re 45,” Obeid says. “Every 17-year-old see a new world of potential once they master the basics of driving, but they can barely grasp the risks it brings. Disruption is a lot like that; business units can have brilliant ideas, but not understand the forces they might unleash. Audit can help channel those forces in a way that’s still exciting, but not reckless.”

And that, after all, is what boards truly want: disruption, but disruption *harnessed intelligently*. Then the business can go with the herd: moving through it, and taking whatever position within it that seems best.

Practical Tips and Techniques

As outlined by Charlie Wright, director, Enterprise Risk Solutions at BKD LLP in Edmond Okla., in the December 2017 *Internal Auditor* magazine *Risk Watch* article “Tomorrow’s ERM Today,” there are several ways internal auditors can help manage the effect of disruptive technologies on their organizations.



Focus on Assurance

Internal audit should continue to focus on what it does best. By continuing to focus on risk management, control, and governance, auditors can help ensure that processes are designed and operating effectively — regardless of the speed of disruption. By proactively helping the organization anticipate emerging risks and technological changes, internal audit can be positioned as an authority and help prepare the organization to respond to disruptive events.

Engage with Stakeholders and Subject Matter Experts

Align internal audit's work with the expectations of internal audit's key stakeholders. Work closely with subject matter experts who are implementing disruptive technologies and focus on the most relevant and significant issues.

Invest in Training on Disruptive Technologies

Constantly pursue training to learn about new technologies and the complex and emerging risks being introduced to the organization. Chief audit executives should develop an adaptive, flexible, innovative staffing model to tap into a highly specialized talent pool with technological competence and the ability to rapidly understand and leverage new tools, techniques, and processes.

Put New Technologies to Work

Embrace and leverage new technologies in performing internal audit work. Internal auditors need to be at the forefront of adopting artificial intelligence, cognitive computing, and smart robots. Auditors need to understand how technologies such as blockchain work and how they can be used in their organizations. They must take advantage of machine learning and data analytics in their audit processes — real-time auditing should be a requirement as organizations implement new business processes.

Closing Thoughts

There may be a lack of synergy between internal audit and innovators or creative thinkers in the organization, but with regard to disruptive events that the organization either generates or reacts to, internal audit should be there from the beginning.

By focusing on assurance, engaging with subject matter experts, investing in training and disruptive technologies, putting new technologies to work, and providing insight into emerging risks and opportunities, internal audit may be seen as a key asset in helping the organization to harness the power of disruption.

That, after all, is what boards truly want: disruption, but disruption harnessed intelligently.



About The IIA

The Institute of Internal Auditors (IIA) is the internal audit profession's most widely recognized advocate, educator, and provider of standards, guidance, and certifications. Established in 1941, The IIA today serves more than 190,000 members from more than 170 countries and territories. The association's global headquarters are in Lake Mary, Fla., USA. For more information, visit www.globaliia.org.

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