

Role of Internal Audit in Transformational Change

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Core Competencies – C21



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Agenda

1. Introduction
2. Transformational Change
3. Industry Trends
 - a. Transformational Change
 - b. Internal Audit
4. The Risks and Internal Audit's Role
5. The Rise of Agile
6. Practical Examples
7. Questions

INTRODUCTION



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TRANSFORMATIONAL CHANGE



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What is transformational change?

Transformational change is designed to improve performance, build capabilities, and strengthen behavior over time.

- ERP implementations (or re-implementations)
- New go-to-market strategies or markets
- New products or services
- Cultural change initiatives

INDUSTRY TRENDS

TRANSFORMATIONAL CHANGE



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Transformational change market trends

- Accelerating investments in significant projects to enable **business transformation** initiatives.
- **IT spending has been cut** over the last few years resulting in a backlog of IT projects.
- Projects are **increasingly complex**, frequently requiring collaboration across geographies and organizations.
- **Multiple and uncoordinated** assurance requirements; IA, external audit, SOX, Compliance, Risk Management

Transformational change market trends

- Organizations are **resource-constrained** – not adequately staffed to advance projects and maintain existing operations.
- **Significant system upgrades continue** — we are entering new era of “re-implementations” and/or system change outs.
- **Regulatory requirements are expanding**, adding to compliance efforts.
- **Complex dependencies** across project portfolios.
- The rise of **Agile delivery methodologies**

Fact

50%

...of projects fail or
exceed budget.

Fact

70%

...do not meet user expectations.

Fact

85%

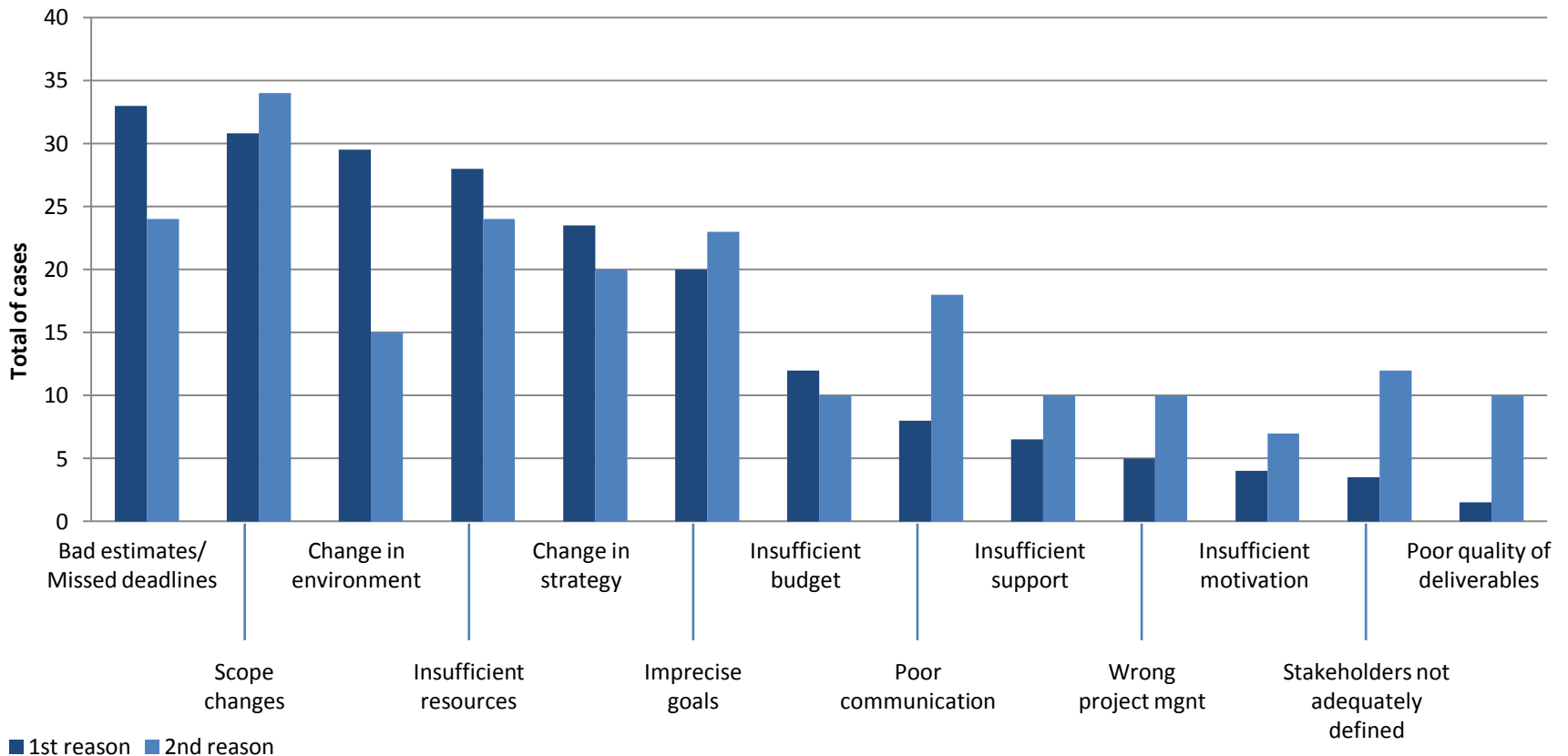
...do not realize the
business case.

Fact

30%

...of projects are cancelled.

Reasons for project failure



There is a need for increased project discipline and support in the marketplace, as well as **independent** review.

INDUSTRY TRENDS

INTERNAL AUDIT



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Internal Audit State of the Profession

- 9th Annual State of the Internal Audit Profession Study
- Second year where we explored the impact of Internal Audit from the lens of a stakeholder
- Over 1700 respondents, Audit Committee Chairs, Board, CEOs, and CFOs, participated including 630 executive stakeholders
- Over 140 personal executive interviews conducted
- Focus areas included
 - Stakeholder's expectations of IA
 - Performance and value of IA's contribution
 - IA's contributions in emerging risk areas
 - Characteristics of IA functions



The State of the Internal Audit Profession 2012

92%
of CAEs

- ...consider project risk as either important or very important.

82%
of Executives

- ...think large program risk is considered well managed.

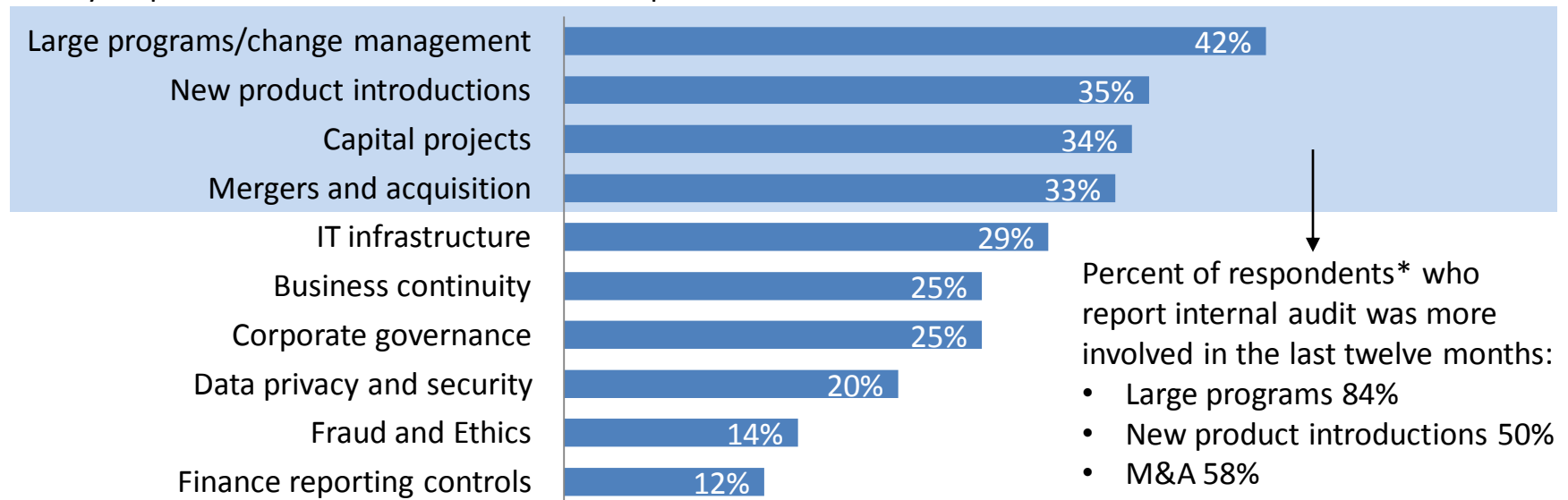
27%
of CAEs

37%
of Executives

The State of the Internal Audit Profession 2013

Internal audit continues to struggle in maximizing its contribution in areas outside of its traditional focus

Survey respondents were asked to rank their top three areas of least satisfaction with internal audit



Percent of stakeholders who have this area in the top three areas of dissatisfaction

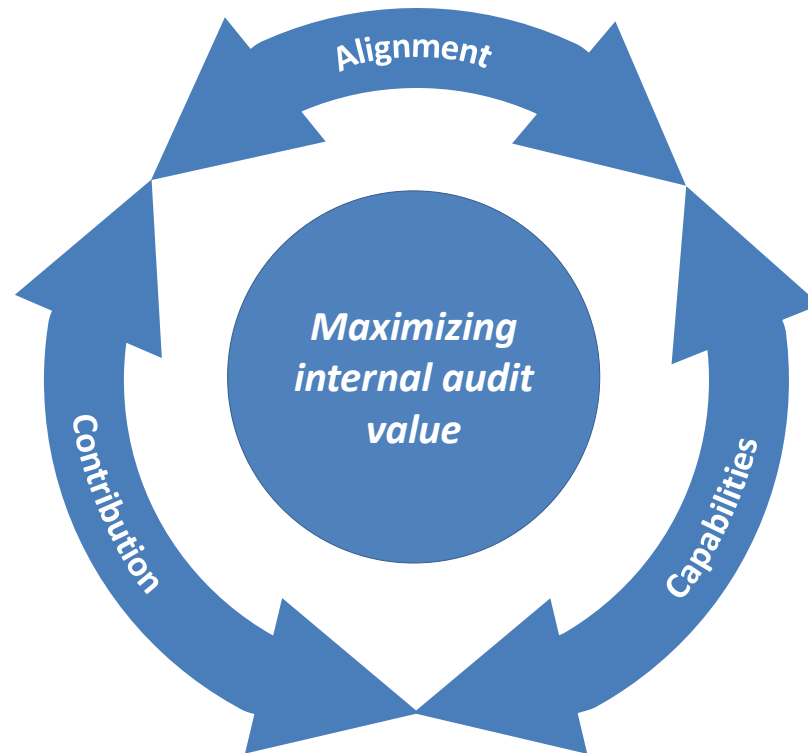
* Respondents = subset of total who reported the risk presented more of a threat in the next year than in the past year

Increased internal audit focus has not translated into greater stakeholder satisfaction

Examining the issues

Our survey data revealed the circular nature of the internal audit challenges

The issues of stakeholder alignment, a challenged capability foundation and sub-optimal internal audit contribution are tightly interwoven



Internal audit must break the cycle of inaction and increase its capabilities or risk being marginalized in comparison to other risk functions

Examining the issues

Stakeholders are not aligned in their views on internal audit's value and performance

- **Value**
At the most fundamental level, stakeholders have significantly different views of internal audit value
- **Performance**
This year's research confirms that strong performance in the eight core attributes directly correlates to greater value.
- **Critical Risks**
Stakeholders are not aligned on critical risks facing the organization which creates challenges for internal audit in addressing those critical risks

79% of board members see significant value, while only 44% of management do

56% of the board ranks IA performance as strong, while 37% of management do

60% of the board members believe risks are well managed vs. 52% of management

Board members' views on value versus performance do not reconcile – 79% see significant value, yet only 56% view performance as strong – a 23% difference

Heart of the matter

Stakeholders want more and internal audit can deliver

Internal audit continues to face challenges

- Stakeholders are not aligned in their views on internal audit's value and performance
- Internal audit's capabilities are not keeping up - what was once leading practices are now the new floor
- Internal audit continues to struggle in maximizing its contribution, especially in less traditional areas Internal audit's performance is not keeping up with – what was once leading is now the new floor

Key takeaways

- Alignment must be achieved amongst stakeholders and CAEs on internal audit's role in the organization, what internal audit value means and where internal audit should be focused
- Internal audit must break the cycle of inaction and improve its performance on eight core attributes

Our research has revealed internal audit functions performing at a high level provide a distinctively different level of service

The path forward

Our survey identified need for urgent action on part of stakeholders and CAEs alike

Audit Committee: Ask More

- Ask yourself if your expectations of internal audit are high enough
- Ask if critical business risk coverage is aligned with your views on risk
- Ask if internal audit has a strategic plan and resources to deliver
- Ask if you are enabling internal audit to be what it should be

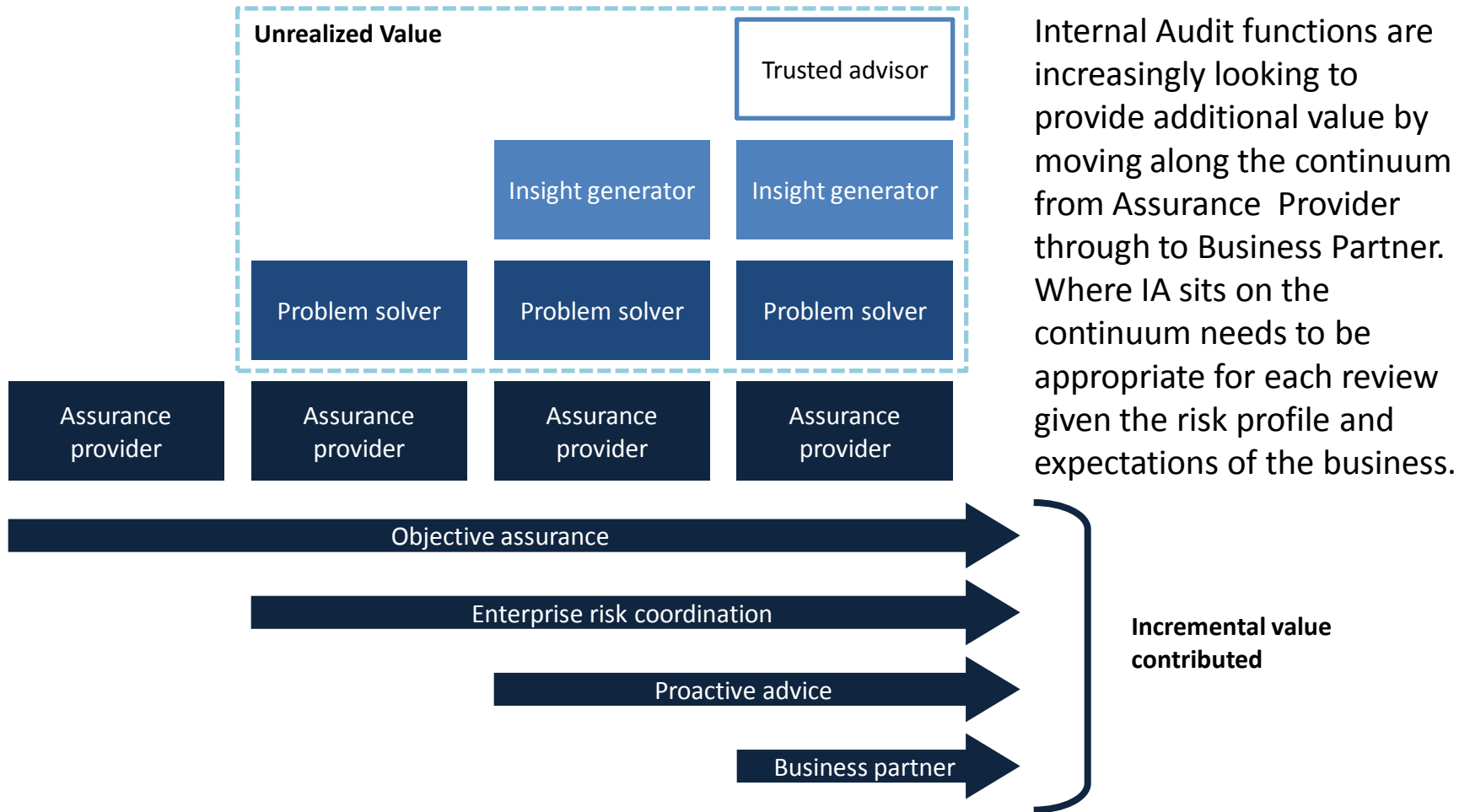
Management: Expect More

- Expect internal audit to perform at a higher level and bring more value
- Expect internal audit to have a stronger enterprise-wide risk assessment process
- Expect internal audit to deliver value for the investment but recognize the need to invest
- Expect a robust dialogue with internal audit and provide candid feedback

CAEs: Deliver More

- Deliver high quality on foundational areas
- Deliver a strategic vision that aligns with stakeholder expectations
- Deliver value for investment
- Deliver proactively

Internal Audit market trends



What brings value and differentiates Internal Audit today?

- ‘Timely and concisely defined risks with the consideration of practical and workable remediation solutions’
- *Steering Committees*
- ‘Providing independent risk lens across project, business, and control related risks’ - *Audit Committees and Boards*
- ‘Engaging in robust two-way dialogue around emerging risks and what impact these may represent to the company’
- *Project Management Offices*
- ‘Providing ‘voice-of-the-customer’ perspective’
- *Executive Sponsors*
- ‘Limiting non-essential or general audit techniques’
- *Project Team*

Transforming Internal Audit Challenges

- Building a **portfolio risk assessment process** which considers the current and emerging risks and evolves with project delivery.
- Enhancing existing **project audit methodology** to consider current techniques and more dynamic application
- Understanding and **leveraging the ‘lines of defense’** appropriately
- **Acquiring the right resources** and skill sets to assemble the team
- Identifying effective methods for **communicating and reporting risks** timely

THE RISKS AND INTERNAL AUDIT'S ROLE



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Taking a holistic approach to risk



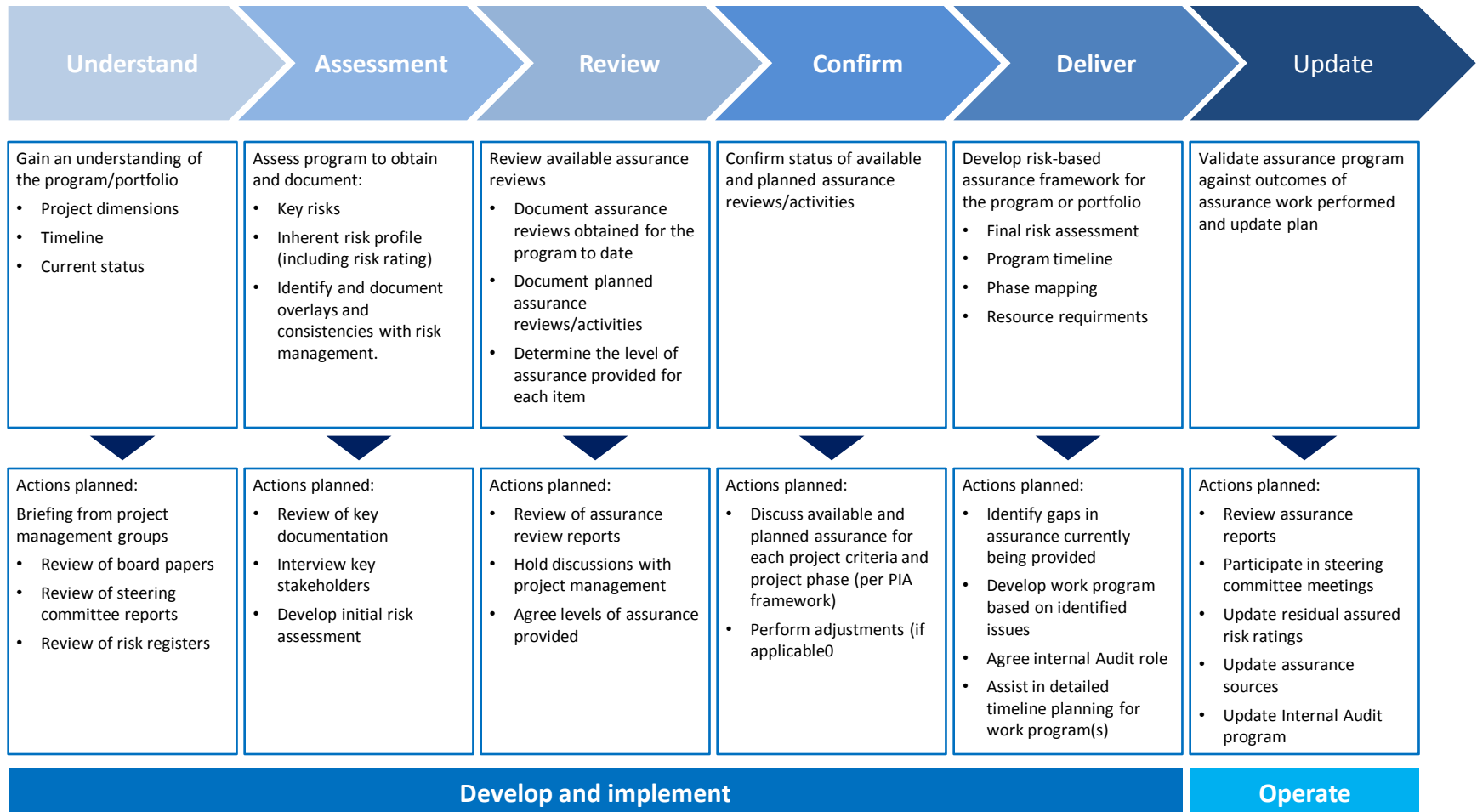
Taking a holistic approach to risk

- 1 Get involved early
 - 2 Build a 'three lines of defense model'
 - 3 Develop an integrated assurance plan
 - 4 Operate the integrated assurance plan, making responsive changes based on the shifting risks
 - 5 Use subject matter specialists
 - 6 Agree how, when and to who you will report
 - 7 Focus on value
-

Get Involved Early

- The earlier Internal Audit gets involved the better
- Increases the understanding of the program's lifecycle and its key benefits, drivers and objectives
- Contribute to the definition of the risk management approach and strategy
- Greater alignment of the program's risk management principles to those of the organization itself
- Confirm future involvement and method of engagement based on the level of inherent risk in the transformation
- Leverage experience of specialists

Get Involved Early

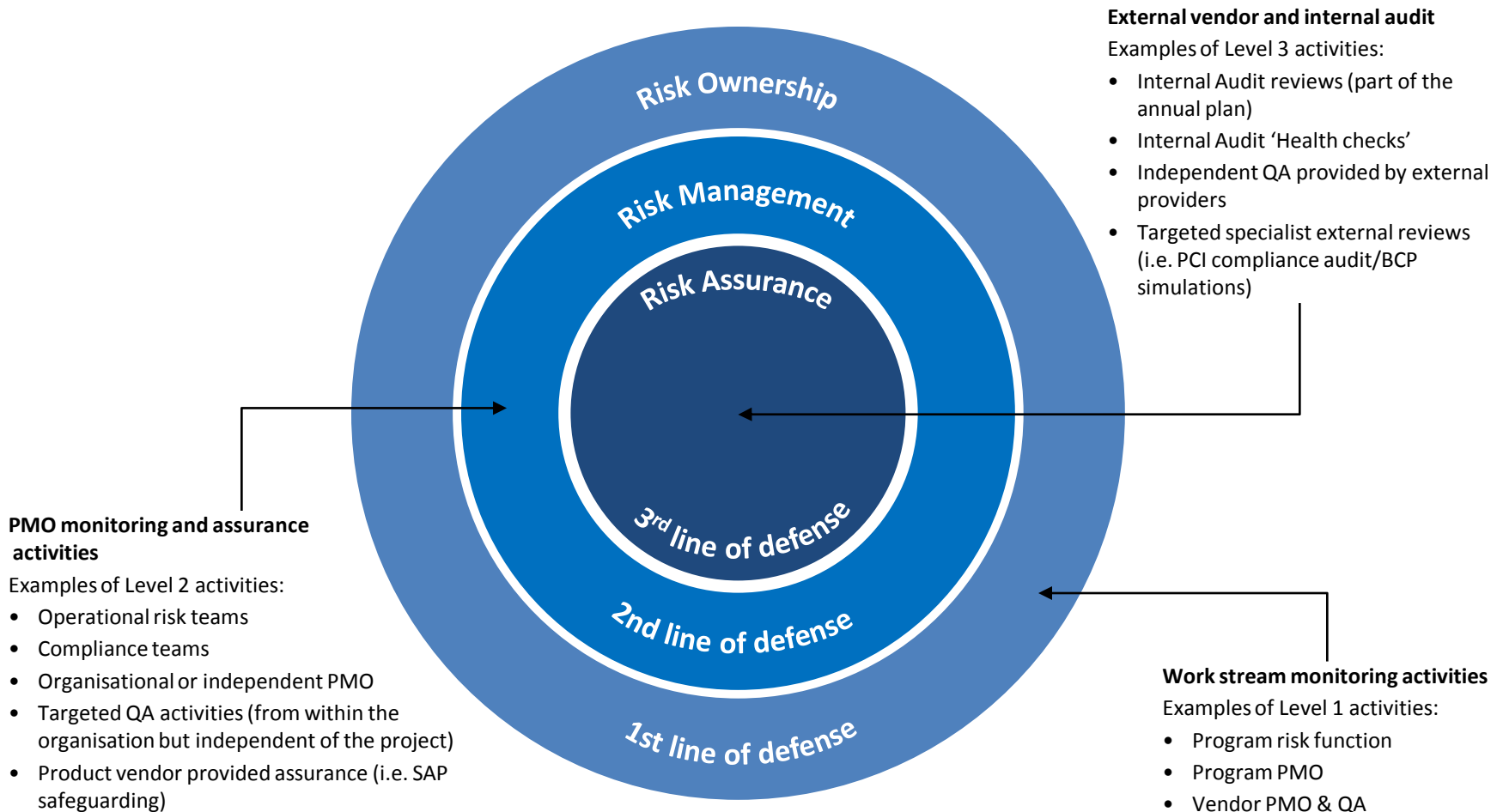


Build a ‘three lines of defense model’

Build a three lines of defence model that aligns to the organization’s approach. Consider the sources of assurance that are available to the program and the extent to which they are already planning to rely on them.

- Quality assurance (QA) activities within the program
- Event-triggered or stage-gate reviews performed by PMO functions
- QA outputs from the vendor (e.g. reports to the program that their team is operating in accordance with methodologies)
- Operational risk team reviews
- Internal regulatory and compliance reviews
- External audit activities.

Three Lines of Defense

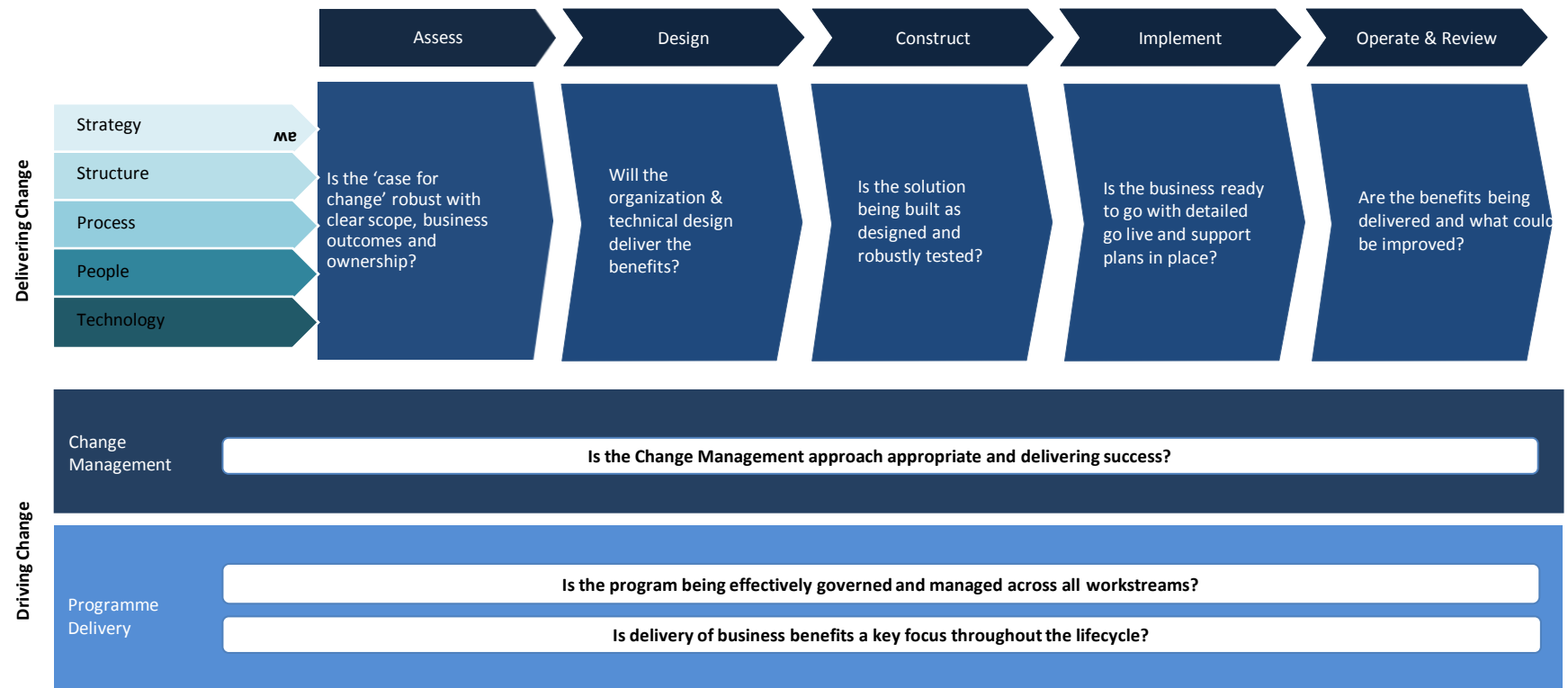


Develop an integrated assurance plan

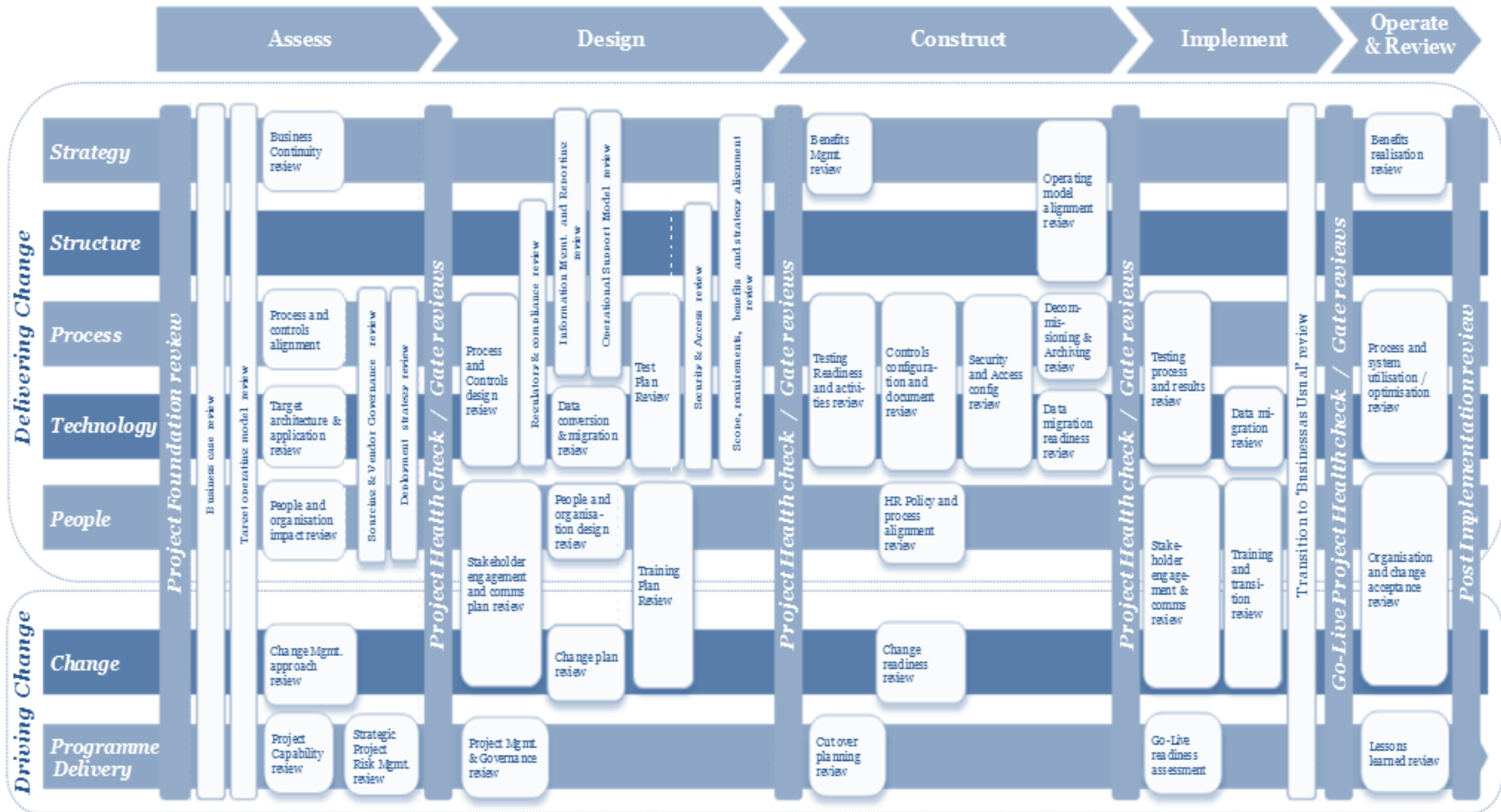
- Risk driven integrated assurance plan that is aligned to the three lines of defense.
- Operates at a program level
- Some of its activities might be included in the broader Internal Audit plan, but not all
- Use a framework to map key risks across the lifecycle
- Focus on high-risk areas with low coverage and low risk areas where too much work is occurring
- Develop early to minimize disruptions
- Identify efficiencies where different assurance functions can take comfort from each other's work

Integrated Program Assurance

Use a framework to look across the whole program and into the key areas that are typically critical to successful delivery. An initial risk assessment or benchmark is performed at on-set of the engagement to identify and understand relevant risks for the specific project being reviewed and to focus review efforts going forward on these key areas.



Integrated Program Assurance



Operate and adapt your plan

- Review and align high level scope and risk coverage
- Confirm follow-up of previous outcomes
- Assess the timing of reviews to align them with program deliverables and management of review outputs
- Assess the impact on resourcing
- Assess emerging risks and their relevance to the program
- Continue to look for any synergies and efficiencies

Use subject matter specialists

- Ensure a sound understanding of the problems and risks
- Establish credibility and confidence with the program team
- Build empathy with the program team
- Bring insights and perspectives from similar programs or industries
- Be practical and pragmatic about the materiality of any issues raised in the context of the program versus reviewing against a methodology.

Agree how, when and to who you will report

- Who will the report be provided to and who will be responsible for tracking any agreed actions?
- Are all reports rated in accordance with the same risk/rating scale?
- Are the timelines for agreed resolution of activities consistent based on the rating scale used?
- How does the rating scale align to the program's risk rating scale and the organization's risk rating scale?
- Do the reports specifically state new risks that should be included in the program risk registers?
- Are the outputs of the assurance activities shared with other assurance providers to inform detailed scoping?
- Will all assurance outputs and agreed action registers be centrally managed?

Focus on Value

- Understand what is important to:
 - Steering Committee
 - Audit Committee and the Board
 - Project Management Office
 - Executive Sponsor/s
 - Project Team
- Build your approach accordingly
- Don't focus on the things that aren't important
- Understand the objectives and benefits of the program

THE RISE OF AGILE



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Typical agile audit concerns

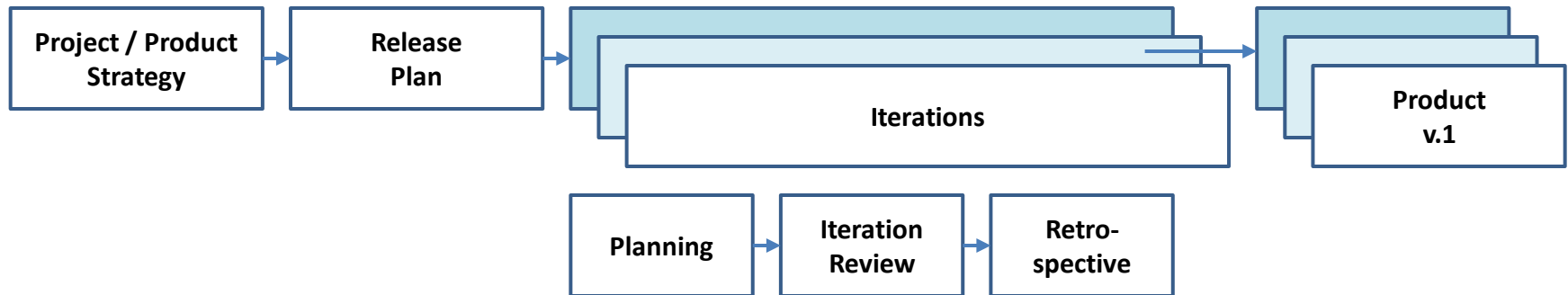
1. How is QA and independent testing handled in agile? What about formalizing, documenting, reviewing and approving scripts? How is regression testing and UAT handled in agile?
2. What are the inherent risks in agile vs. waterfall that need to be considered?
3. What environments are required (Dev/QA/Prod)?
4. What actually gets moved into production?
5. How are reviews and approvals documented throughout the lifecycle?
6. How does a geographically distributed team work in Agile? What about organizational boundaries?

What is agile?

Agile is a software development framework that delivers business value quickly and efficiently through rapid and frequent software delivery to the customer.

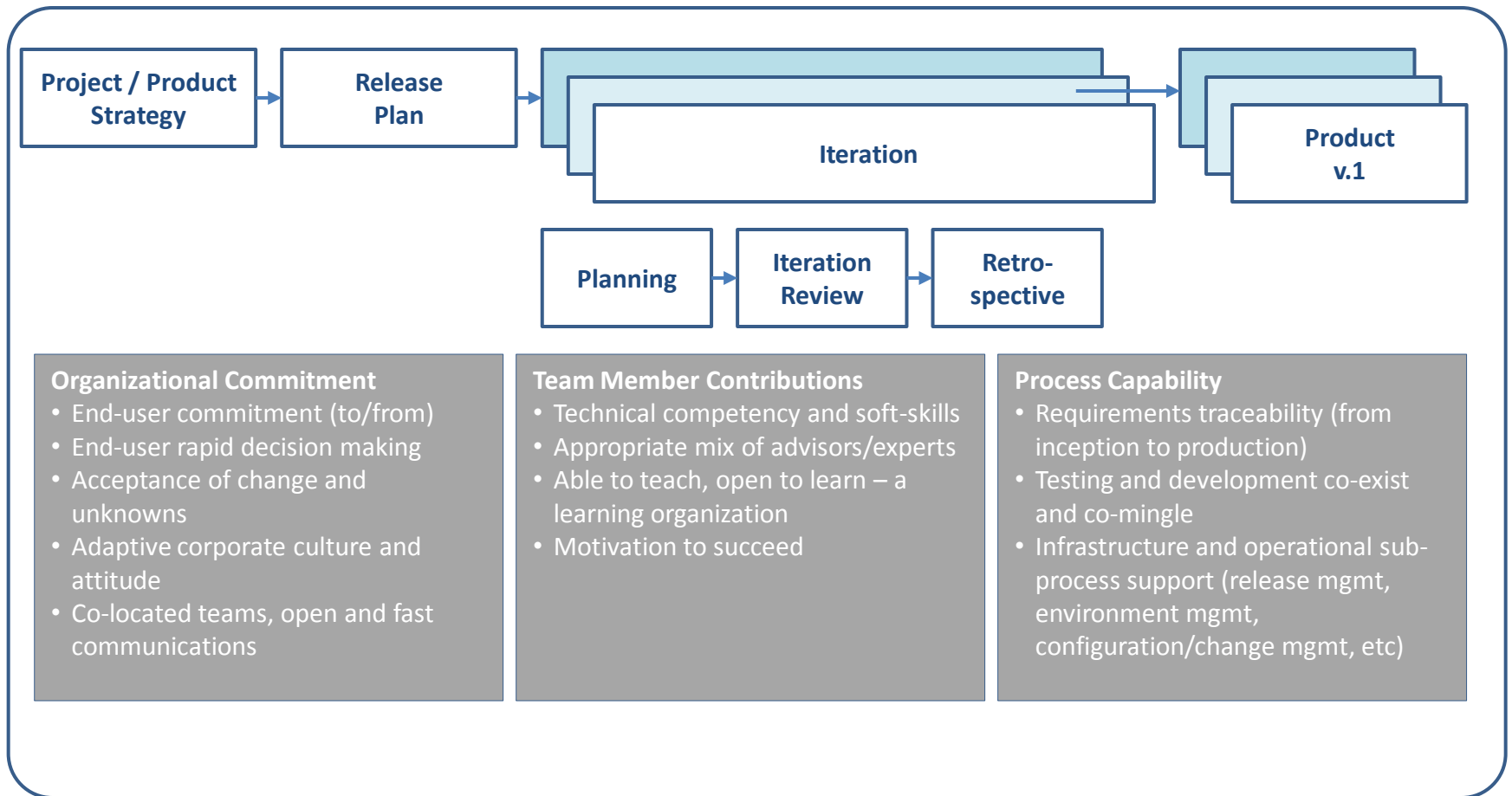
- Agile focuses on the following core values:
 1. Individuals and interactions are more valuable than processes and tools
 2. Working software is a higher priority than comprehensive documentation
 3. Customer collaboration versus contract negotiation
 4. Responding to change is preferable to a rigid plan
- Agile has many interpretations including Extreme Programming (XP) and SCRUM (the most popular)

Typical agile lifecycle



- Project and Product Strategy
- Release Plan
- Iteration Planning
- Iteration Review
- Retrospective
- Product Delivery

Critical success factors



What are the advantages and disadvantages of agile in comparison to waterfall?

Advantages	Disadvantages
<ul style="list-style-type: none">• Rapid and frequent deliveries to production get the benefits stream going early• Relatively strong commitment to business milestones• Efficient adaption to changing customer priorities and requirements keeps the project current and relevant• Customers get an influential seat at the table to shape the value proposition of the project as it unfolds• The innovative potential of small teams working collectively only on the customer needs• The project objective is customer-centric and not necessarily bound to a plan that is out of date• Validation of customer value is built in and almost automatic by design• Trust by stakeholder and customer is built with actual deeds• A sense of accomplishment and a cause for celebration and reinforcement is offered at each successful iteration and release	<ul style="list-style-type: none">• Weak commitment to overall cost and scope (vs. plan driven projects)• Vulnerable to turn-over in the team staffing• Not architecture driven so there may be many dependencies discovered late (cost of refactoring)• Difficult to scale the small-team dynamics to an enterprise project• Difficult to scale without commitment to documentation• Difficult to engage the work team because requirements and scope are not known with adequate certainty• Depends greatly on favorable logistics for team co-location, face-to-face communications, a pool of talented multi-disciplined staff, and instant access to knowledgeable and empowered customers or end users• Testing is not independent• Verification is by testing, not traceable to specifications*• High reliability and mission-critical requires strong verification

Challenges agile teams/organizations are facing

Agile needs to be tailored to the organization

Speed of agile shows process weakness in other areas

Teams can't scale outside of the war room

Status reporting difficult based on changing baselines

Agile needs to be supported by other methods and processes

Documentation is too light or non-existent

PRACTICAL EXAMPLES



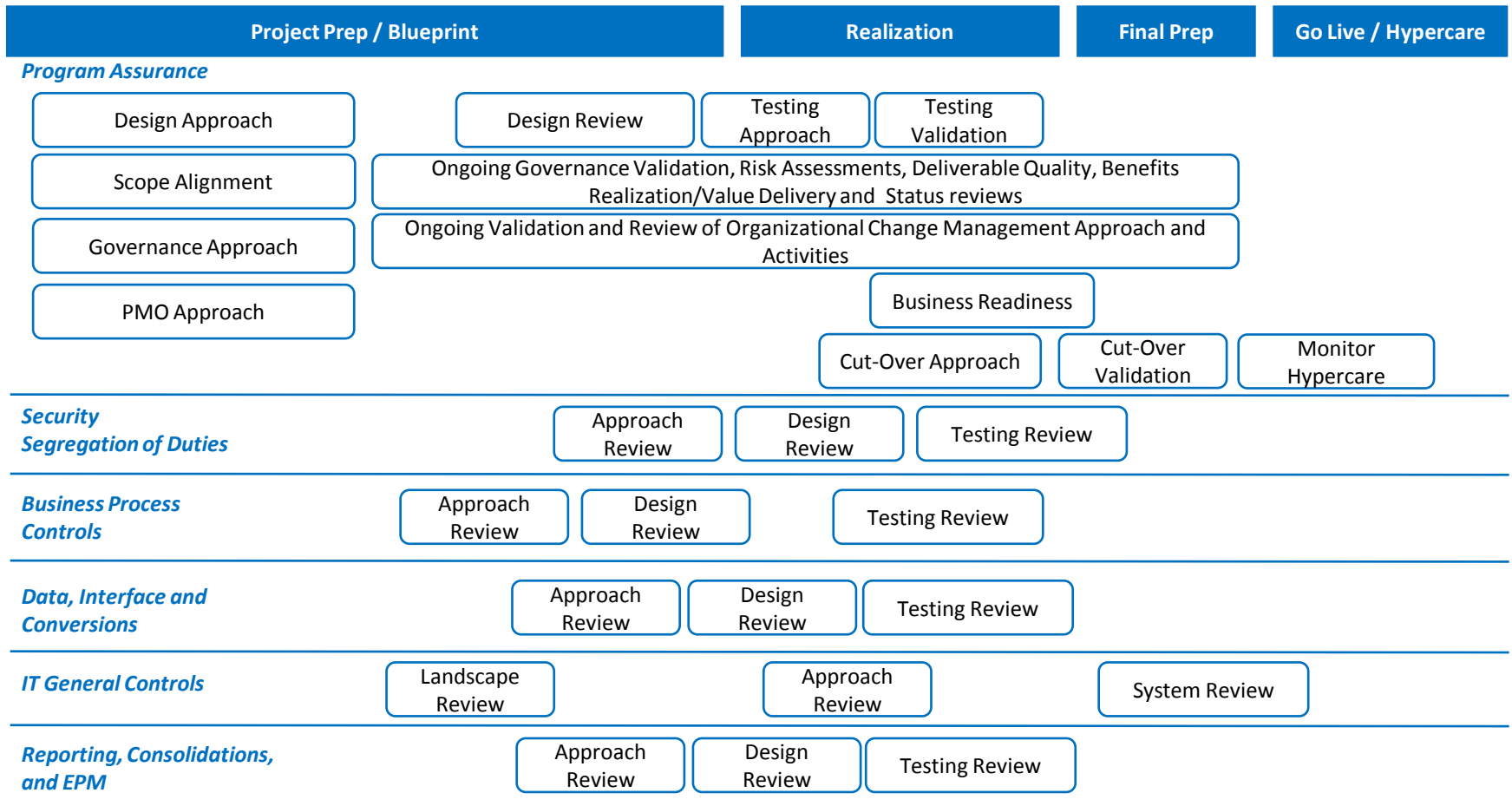
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Practical Examples

- Global Technology Company: 2.5 year SAP implementation
- Global Retailer: multi-year technology transformation

Global Technology Company



Global Retailer

Scope based on what was important to Audit Committee, CFO and Project Team:

- Program / Project Management
- Organizational Change Management
- Stakeholder Expectations
- System Validation
- Business Continuity
- Emerging Risks and Issues Management

The IA team has the freedom to explore anything that relates to the above objectives. The team sits in key meetings and is involved in key decisions. Observations are added to the projects issue management processes, periodic Audit Committee reporting is prepared to coincide with major milestones.

Assessing the Impact of the Change

Organizational change management is a challenge for most organizations, especially those who do not have a strong corporate change culture. The Change Impact and Readiness Assessment (CIRA) framework is a formal process for subjectively identifying and managing the people-related risks in the six critical success factors for managing change. These critical success factors are:

- **Articulate the Business Case for Change** - Define the vision and business case and articulate this at the start of the program to create the impetus for change.
- **Engage & Communicate with Stakeholders** - Develop and deliver key messages to build program awareness, buy-in, and ownership. Utilize feedback mechanisms to gauge effectiveness.
- **Design the Change Strategy** - There is an explicit structure & plan which defines the nature and sequence of specific activities, resources and interdependencies required to facilitate change.
- **Mobilize & Align Leaders** - Leaders' values and behaviors are aligned with the business vision; leaders possess skills to drive change, and accept responsibility for doing so; stakeholder commitment and involvement are in place.
- **Enable Workforce** - A strategy is deployed to ensure that employees and managers have job clarity, tools, and training they will need to succeed in the new environment.
- **Align the Organization** - Organization design and performance management systems are aligned to drive new behaviors and cultural norms in support of the business vision.

Questions and thank you.

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