

2016 State of the Internal Audit Profession Study

Leadership matters: Advancing toward true north as stakeholders expect more

March 2016

PwC's annual survey results make clear that a focus on leadership will increase internal audit's value contribution and help the broader organization address emerging risks.



Leadership matters: Advancing toward true north as stakeholders expect more

Leadership matters and makes a difference in the minds of stakeholders. Internal audit functions that have very effective leadership perform better and add greater value to their businesses. Strong internal audit leaders build functions that excel at delivering value today while they evolve to stay current with emerging business needs and risks. For those reasons, PwC's 2016 State of the Internal Audit Profession Study focuses on the characteristics that define standout leadership so that stakeholders can re-examine their expectations and internal audit leaders can reflect on their own leadership styles in order to achieve closer stakeholder alignment and better performance.



Making progress; more expected

Today's corporate leaders find themselves in a business environment that is becoming increasingly complex. PwC's 19th Annual Global CEO Survey reveals that CEOs are becoming more and more concerned about a wide range of risks, including top threats of overregulation and geopolitical uncertainty. At the same time, those CEOs acknowledge that their customers and other stakeholders increasingly want them to do more in tackling important problems. Despite the tremendous challenges they face in managing their businesses today, they must also look ahead to prepare their businesses for the even more complex global marketplace of the future.

Internal audit leaders face similar challenges. In today's environment of increasing uncertainty, internal audit must have the dual ability to deliver against a complex, ever-changing set of business risks and to progress toward a steadfast vision for the function.

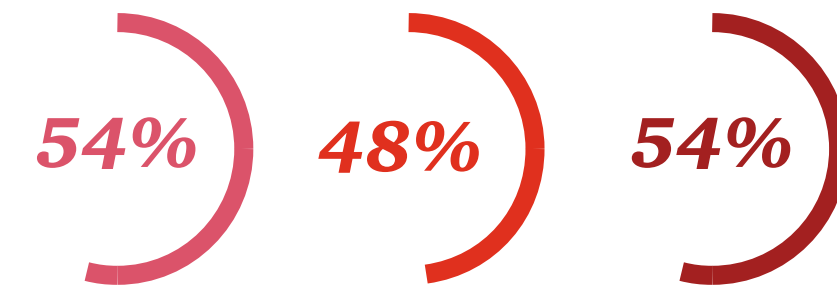
PwC's 2016 State of the Internal Audit Profession Study gathered insights globally from more than 1,600 chief audit executives (CAEs) and their stakeholders, including senior management and board members. This year's study obtained more stakeholder input than ever before. Stakeholders told us that as a profession, internal audit has increased the value it delivers. Overall, 54% of stakeholders now believe internal audit is contributing significant value—up six points from 2015 (Figure 1).

62%

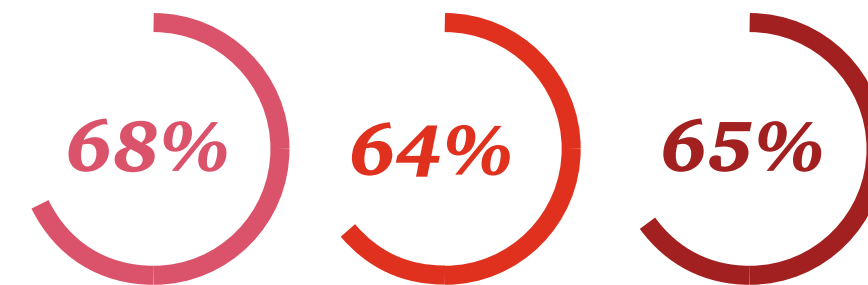
of stakeholders expect more value from internal audit, including nearly half of those already receiving significant value

Figure 1: PwC's State of the Internal Audit Profession Study - Historical data

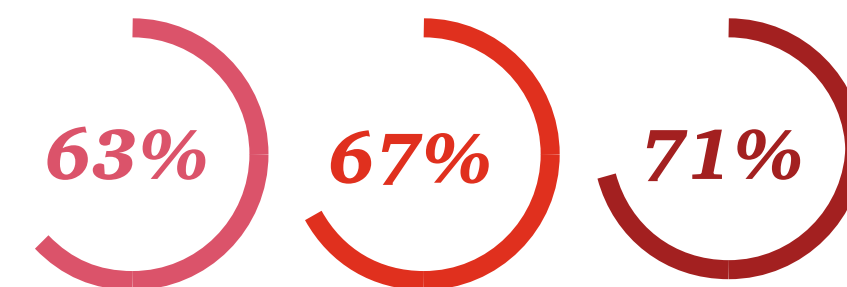
% of stakeholders who say internal audit adds significant value



% of respondents who say internal audit performs well overall

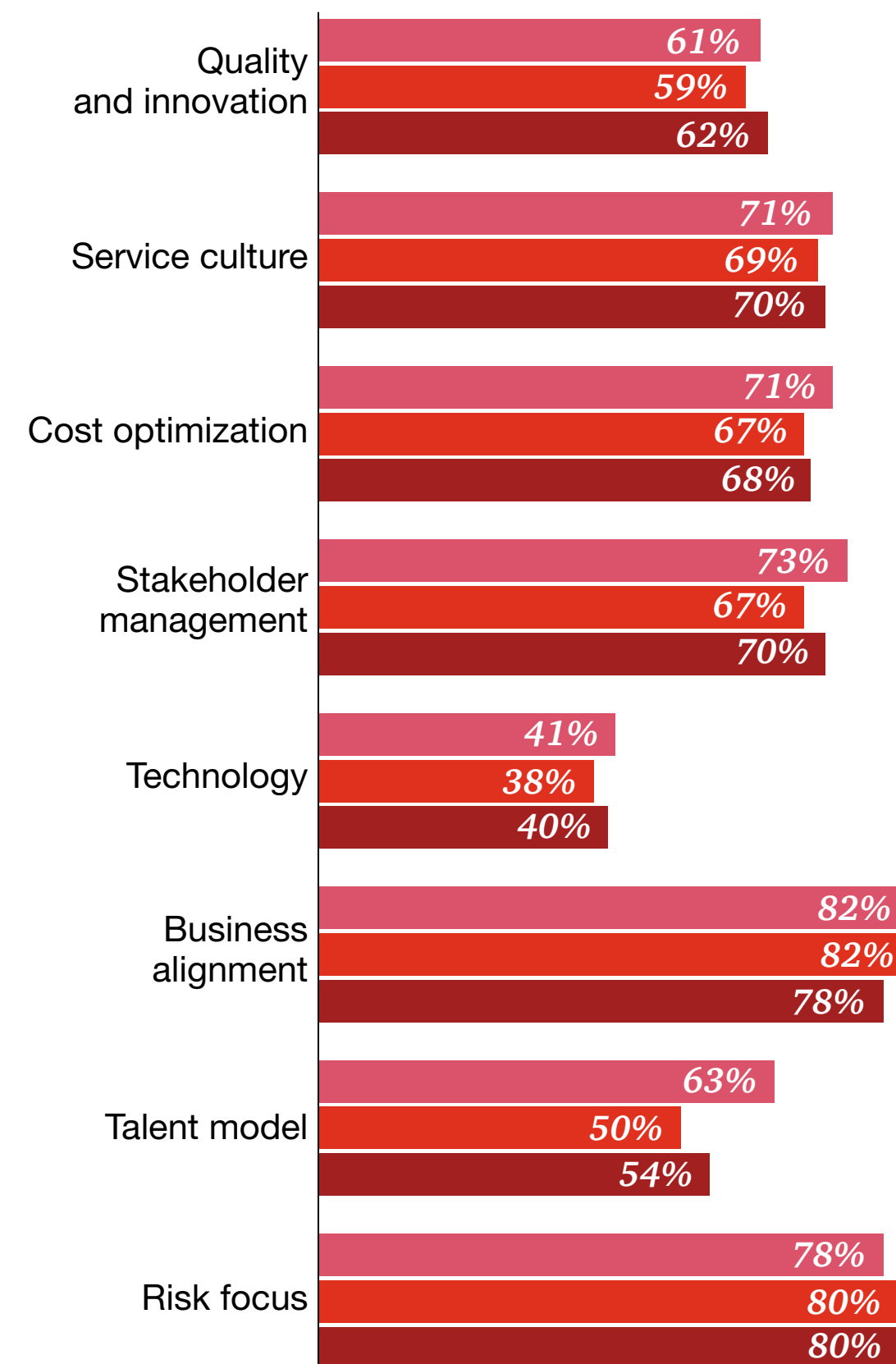


% of respondents who say their organization manages risk well

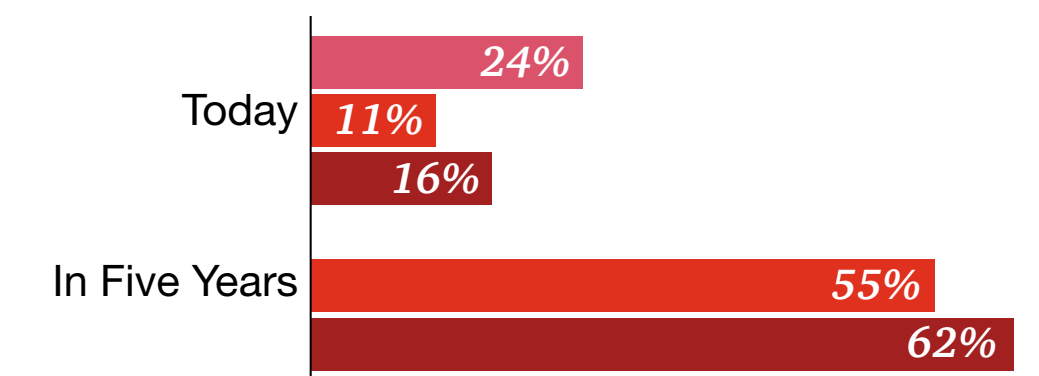


2014 2015 2016

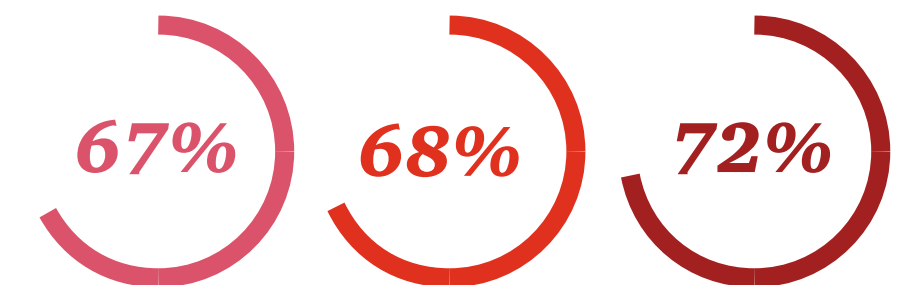
% of respondents who say internal audit performs well, by internal audit performance attribute



% of respondents who expect internal audit to be a trusted advisor within the next five years



% of respondents whose organizations are going through a business transformation or have done so in the past 24 months



Source: PwC's State of the Internal Audit Profession Study, 2014-2016

This is a positive trend, but there is room for improvement, because a number of stakeholders are expecting more from internal audit functions: Overall, 62% of stakeholders expect more value from internal audit, including almost half of those already receiving significant value. Many stakeholders want internal audit to expand its value beyond its traditional role of assurance. Whereas just 16% of respondents say internal audit is providing value-added services

and proactive advice for the business today (which PwC refers to as a Trusted Advisor, Figure 2), 62% expect internal audit to be a more proactive Trusted Advisor within the next five years. This is a trend we have repeatedly seen since we began tracking this question.

But stakeholders can't always define exactly what they want or need. Many of them simply don't understand what's possible from internal audit. And that

gives CAEs an opportunity to work with stakeholders to shape the mandate that will provide the value that stakeholders expect and deserve.

Whatever mandate has been given to a specific internal audit function, stakeholders clearly expect their leaders to generate greater value. In 2015, we introduced the concept of true north, a set of ideals for helping internal audit functions generate additional value by guiding their organizations from their current state to where they want to be. True north is a fixed, orienteering point—an unchanging vision that keeps us on track as the world around us changes. It is abundantly clear that any journey toward true north must be guided by effective leadership.

The correlation between value and leadership

PwC's 2016 State of the Internal Audit Profession Study asked stakeholders to reflect on the qualities of great leaders and to share their perspectives on the behaviors and traits that set great leaders apart from their peers. Almost one-fourth of stakeholders considered their internal

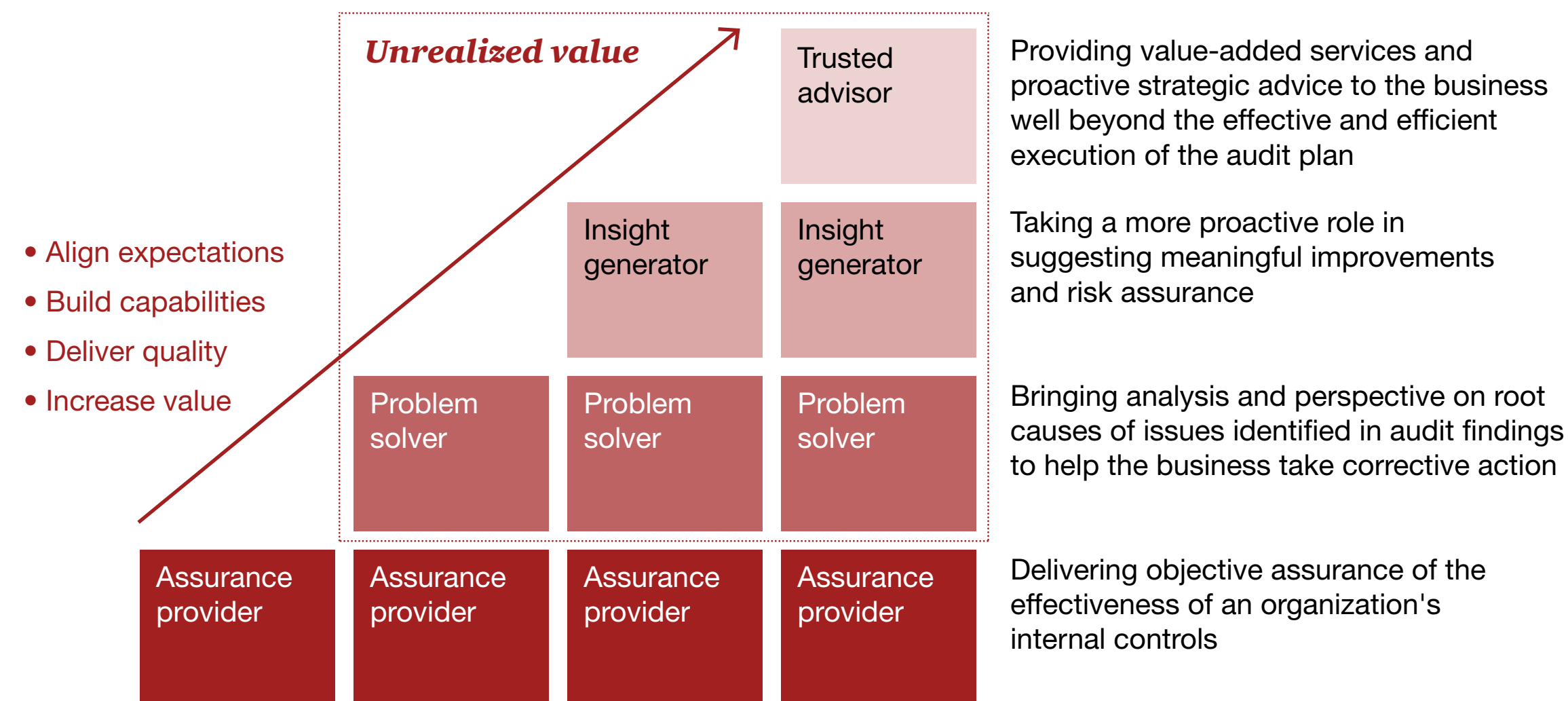
audit leaders to be either very ineffective, ineffective or neutral (we refer to that group as less effective). More than a fourth considered their leaders very effective. The remaining 50% fell in the middle, with their leaders considered at least somewhat effective but with room for improvement (Figure 3).

84%

of internal audit functions classified by stakeholders as Trusted Advisors report very effective leadership

As we compare the differences among those three groups, the data unequivocally show a close correlation between strong leadership and internal audit's ability to add value and deliver strong performance. Even though there are many leaders who demonstrate aspects of effective leadership, stakeholders want more. Very effective leaders set themselves apart. Our data show that moving from being an effective leader to a very effective leader can result in both increased performance and greater value.

Figure 2: The journey to capture unrealized value



Source: 2014 PwC State of the Internal Audit Profession Study

About 9 out of 10 (92%) internal audit functions with leaders considered to be very effective by stakeholders are contributing significant value to their organizations. That stands in contrast to just 52% of functions with effective leaders and 20% of functions with less effective leaders. The 40-point value gap between functions with very effective leaders and those with effective leaders tells us that exceptional leadership

matters. Very effective leaders are much more likely to deliver the value stakeholders expect, especially as those expectations continue to evolve.

Furthermore, internal audit functions operating as Trusted Advisors tell us that leadership is a top enabler of their strategic contribution to the business. Even though internal audit can certainly operate across the value spectrum, those

working to deliver even greater value by functioning as Trusted Advisors will be more likely to succeed with very effective leadership.

A similarly striking correlation results when we review internal audit performance—an aggregate measure of how well internal audit performs across each performance attribute, such as business alignment, risk focus, and talent management. Stakeholders report that 90% of internal audit functions with very effective leaders perform well, which stands in contrast to 62% of functions with effective leaders and just 29% of functions with less effective leaders. The correlation holds true in each of the eight distinct attributes PwC tracks annually that are considered essential to effective internal audit performance (Figure 4).

With leadership sitting at the core of value and performance, stakeholders have an obligation to foster and promote strong internal audit leadership, and CAEs have an opportunity to reexamine how they lead their respective functions.

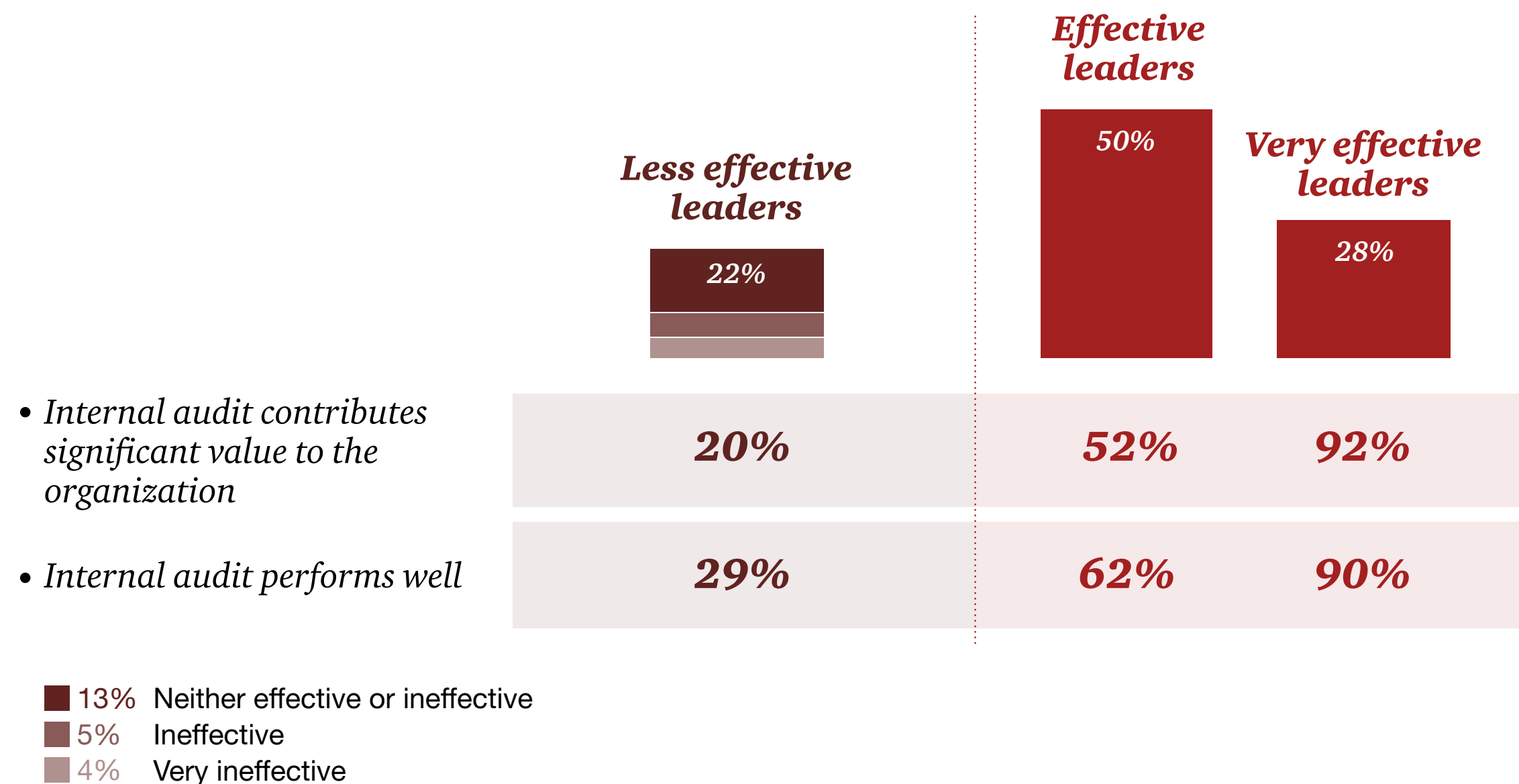
Internal audit functions with very effective leaders deliver more

In our study, stakeholders and CAEs generally agreed on the tangible outputs of a well-led internal audit function. Top-ranking outputs included executing a business-aligned strategic plan, providing insightful root cause analyses of issues, and executing the audit plan according to a business-aligned timeline. It sounds somewhat simple to check the box on these. It’s much easier said than done. Stakeholders are looking for heightened levels of performance in these areas that may seem “obvious” at first glance. In

“A visionary head of internal audit is working to understand what is happening in other parts of the organization. Internal audit leaders need to set aside resources for visioning and strategy development. They need to spend time thinking out of the box and about what might be coming around the next corner.”

Jan Babiak, Walgreens Boots Alliance, Inc. (Audit Committee Chair) and Bank of Montreal (Member, Audit and Conduct Review Committee)

Figure 3: The close correlation between value and leadership: A stakeholder perspective

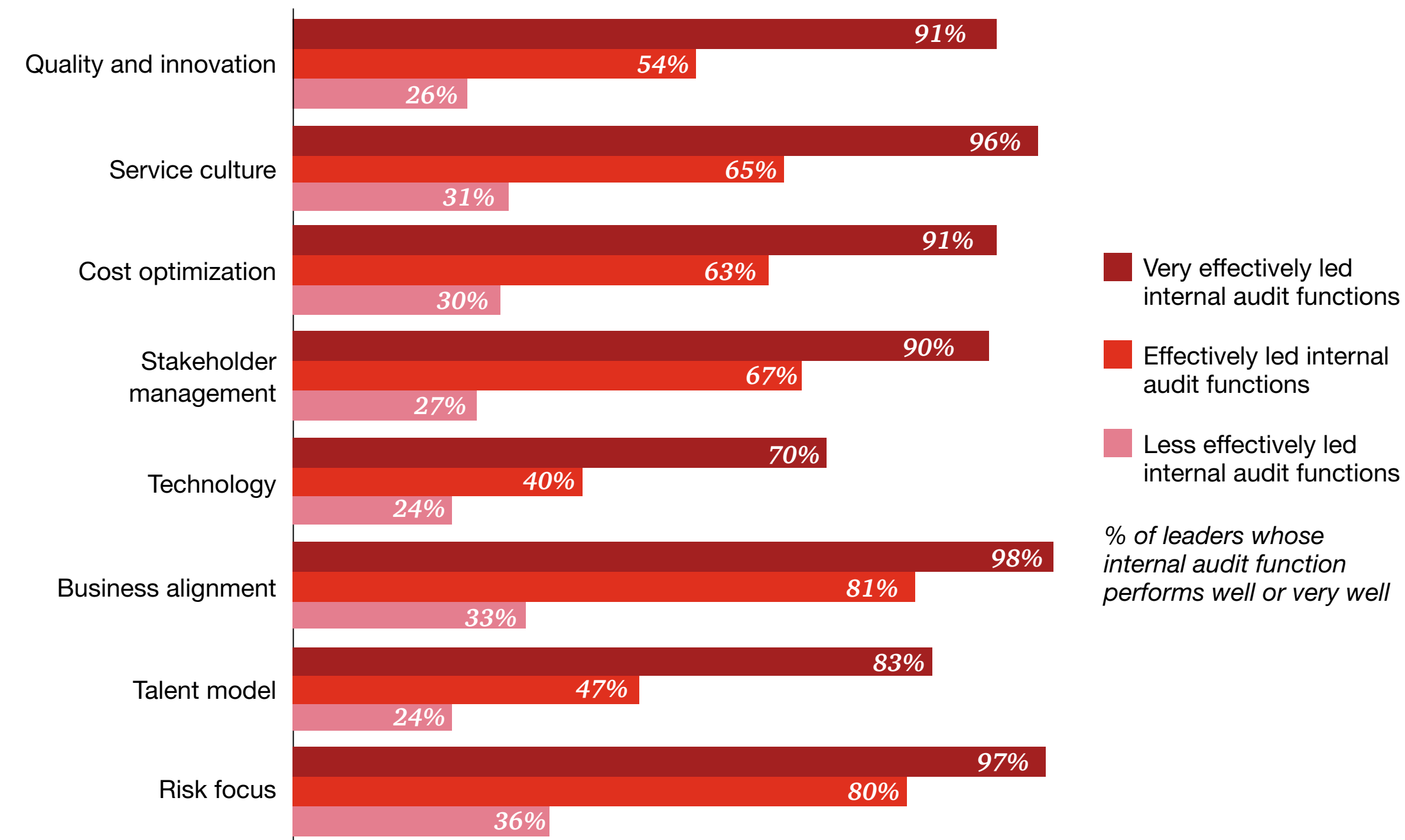


Source: 2016 PwC State of the Internal Audit Profession Study

the eyes of stakeholders, a significant disparity exists between very effective and less-effective leaders in those leaders' abilities to achieve these tangible outputs (Figure 5).

Just as senior executives use a strategic planning process to define corporate strategy and allocate resources accordingly, internal audit executives need their own strategic plans.

Figure 4: Internal audit functions with very effective leaders outperform on The Eight Attributes



[Refer to The Eight Attributes - Delivering internal audit excellence as stakeholders expect more to learn more.](#)

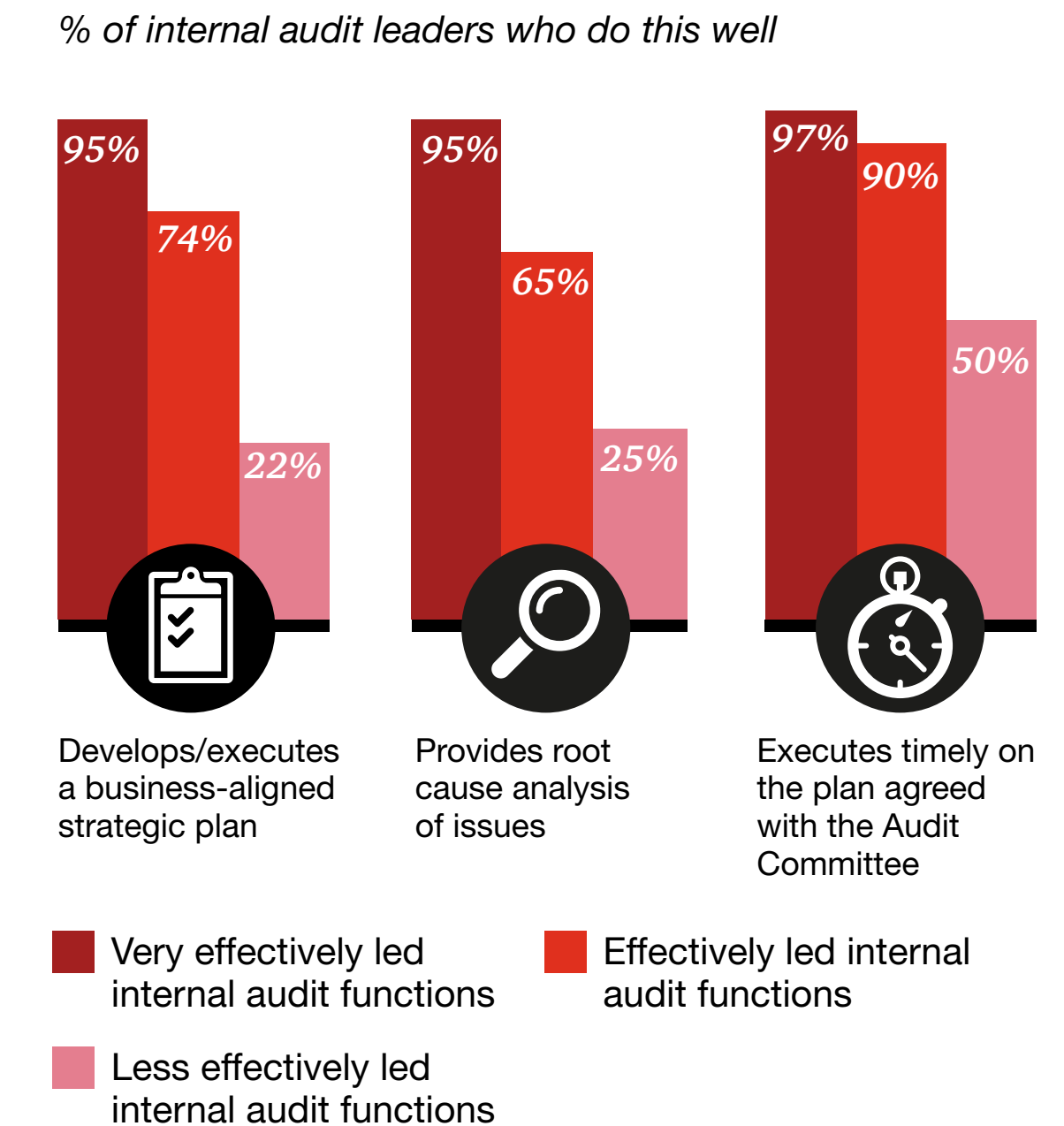
Source: 2016 PwC State of the Internal Audit Profession Study

A business-aligned strategic plan enables internal audit to define and act upon the function's vision in a way that is (1) rooted in a deep understanding of the organization's strategic objectives and risks and (2) enabled by talent, processes, and technology needed to keep pace with the strategic direction of the organization. Once a business-aligned strategic plan is in place, executing the audit plan and providing a root cause analysis of identified issues take on deeper meanings.

Execution of the plan takes place within a context whereby stakeholders understand and agree with the objectives of the audit plan and resources are deployed based on the level of expertise needed, rather than constraining the scope of an audit plan or an individual audit to match the skill sets currently resident in the function. In addition, root cause analysis involves providing broader perspectives, deeper business insights, and identification of thematic issues—not just reporting the issues uncovered during an audit. Very effective leaders also share perspectives with impact to explain

the issues that arose and to highlight where management must change, in order to accelerate implementation of necessary improvements and ultimately reduce risk to an acceptable level. Even something as basic as completing the audit plan in a timely manner is facilitated by effective leadership.

Figure 5: Very effectively-led internal audit functions deliver better outcomes



Source: 2016 PwC State of the Internal Audit Profession Study

How very effective leaders deliver for greater value

Having established that internal audit functions with very effective leadership perform better and add greater value to the business, what defines a strong leader in the eyes of stakeholders? PwC conducted nearly 100 interviews as part of this year's research, recognizing that the most effective way to dive deeply into the topic of leadership was to speak to both stakeholders and CAEs about the characteristics that define the topic. We then analyzed the interview findings, and what came to the forefront were five characteristics that are consistently exhibited by the most-effective internal audit leaders (Figure 6).

Figure 6: Characteristics of effective internal audit leaders



- **Vision**

Very effective internal audit leaders possess a strong vision that aligns with both an organization's strategic direction and stakeholders' expectations. Visionary leaders are able to see not only where they want to go but also what they have to do to get there, fostering innovation within their function.

- **Talent**

Very effective leaders excel at the development and mentorship of people and have the courage to design a talent model that aligns with both a company's business and internal audit's vision. Internal audit leaders who excel at talent management deploy various strategies that deliver the right people with the right skills in the right locations at the right times, by leveraging external resources in addition to internal talent to meet the organization's needs.

- **Position**

Strong positioning within an organization empowers very effective leaders to facilitate proactive discussions about strategic risks the organization is facing, and creates a platform for leaders to influence others in order to build an effective culture of controls throughout the organization. Very effective internal audit leaders are empowered by stakeholders to drive value and change, and they use their position to offer greater business contributions.

- **Communication**

Very effective leaders are confident, composed, and authentic. They bring bold perspectives, think broadly about the organization, and communicate powerfully as peers in executive forums. In fact, very effective leaders excel at communicating with stakeholders, drawing connections, effecting change, and communicating the value delivered.

- **Business Alignment**

Very effective leaders focus on developing trust-based relationships throughout the business. By establishing close partnerships, they better understand what is happening in the business, align with transformational changes, and get ahead of risks while balancing objectivity. Very effective leaders also collaborate across the lines of defense to play greater roles in the coordination of risk management across functions, to make sure that risks are handled effectively and with optimal efficiency, while maintaining objectivity.

We explored these leadership characteristics in greater depth to get a better understanding of the underlying behaviors more commonly exhibited by the most-effective internal audit leaders.

Vision

It is the ability to create a vision for the internal audit function and stay the course that enables very effective leaders to remain business aligned. Very effective leaders are confident about preserving their vision even during periods of significant change and are able to adapt with the organization as new risks emerge. One stakeholder put it this way: “CAEs need to think three steps ahead and understand the direction the company is heading. What is the strategy? And how does the risk profile change?” Very effective leaders build a culture of innovation by encouraging the

team to try new things, by empowering employees, and by inspiring those beneath and around them to succeed.

Our study identified three behaviors in particular wherein very effective leaders stand out. First, very effective leaders are more likely to have translated their visions into strategic plans. More than half (52%) of very effective leaders have strategic plans in place compared with 39% of effective leaders and 26% of less effective leaders. The strategic plan provides the mechanism whereby internal audit can look forward at future

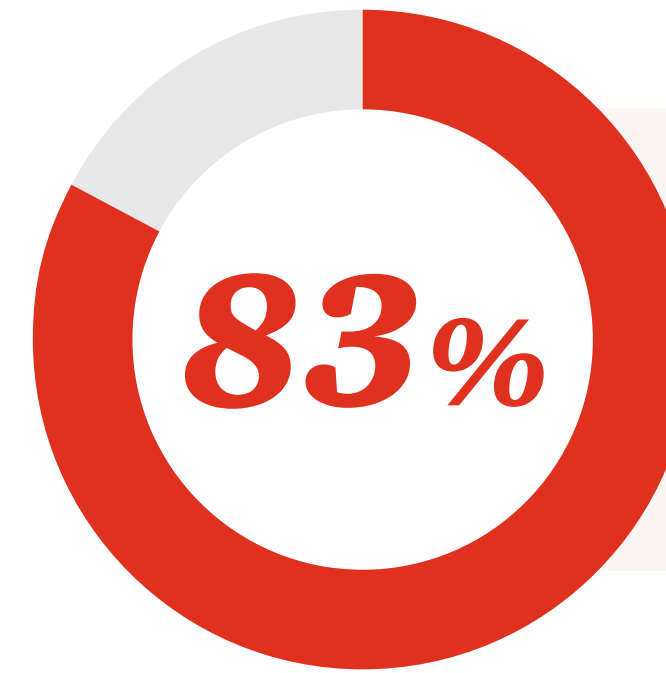


needs and translate those needs into the actionable steps it will take to meet them. As set forth in PwC’s paper entitled [“Internal audit strategic planning,”](#) a six-step process guides internal audit, starting with an understanding of the organization’s plans—which may encompass strategies involving new technologies, business models, or international expansion—and going on to identification of relevant internal audit talent and capability gaps, definition of initiatives to fill those gaps, and creation of timelines and scheduling.

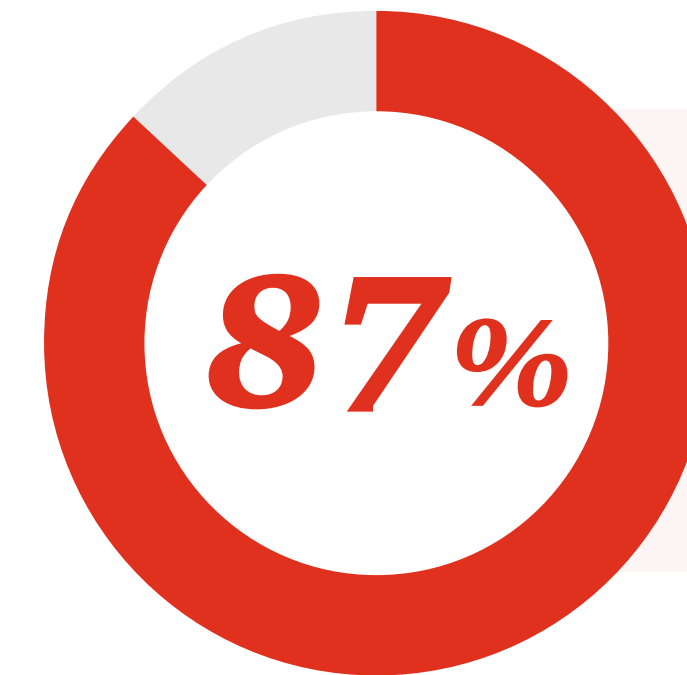
In addition to strategic planning, very effective leaders also invest in capabilities in support of their vision. Recognizing that the profession is evolving, very effective leaders are innovating processes by investing in data analytics and technological tools more often than their less-effective peers. The objective of analytics is not simply to automate isolated audit procedures but to transform the way internal audit functions. Analytics are embedded in risk assessment and integrated throughout

“As I transitioned into the CAE role, developing a strategic plan was imperative to realizing my vision for the function. Whether engaging in strategic initiatives, strengthening business partnerships, or adding more value through data analytics - the strategic plan set the path for measurable progress against our goals.”

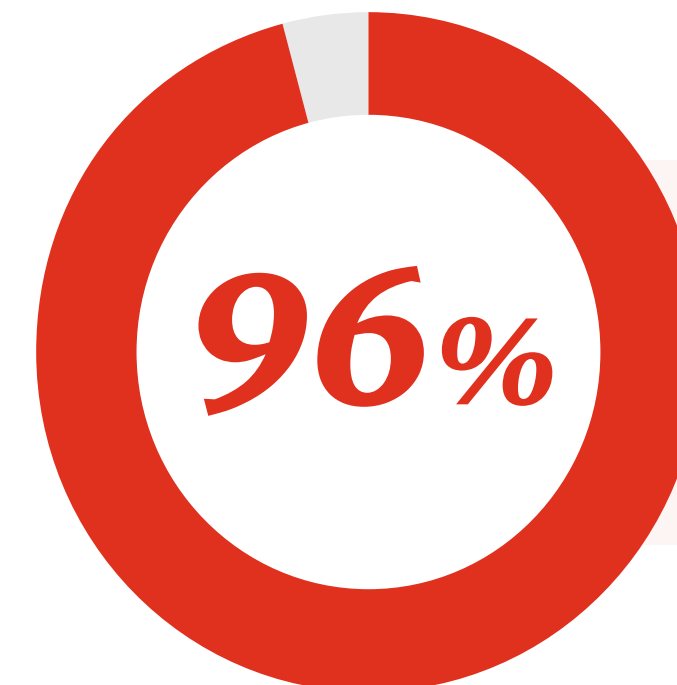
**Lisa M. Halper, SVP and General Auditor,
PepsiCo, Inc.**



of very effective leaders are courageous in pursuing the achievement of goals—even without absolute assurance of success



of very effective leaders are innovative and encourage their internal audit teams to pursue continuous improvement



of very effective leaders translate and execute change well in the eyes of stakeholders

audit planning, fieldwork, and reporting. Caroline Armour, CAE at Verizon, says, “Data analytics and visualization are fundamentally changing the way internal auditors do their jobs; they are changing the internal audit profession.”

Finally, very effective leaders are better at leading their teams during periods of change and thus responding to the organization’s business imperatives. The percentage of very effective leaders skilled at driving transformational change is almost double that of effective leaders. Driving transformational change can take many forms for an internal audit leader, including positioning the function to adapt to strategic changes in an organization’s business model or even beginning the process of collaboration with other assurance functions within the organization so as to deliver greater overall value to the business.

Questions to consider:

- *Has your internal audit function developed a strategic plan? If so, has the plan been shared with stakeholders, including the audit committee? Do stakeholders agree with the direction outlined?*
- *Has your internal audit function identified or made any long-term investments such as in technology or data analytics to enhance the function’s capabilities?*



Journeying toward Trusted Advisor through advanced analytics: Bristol-Myers Squibb Company

Bristol Myers-Squibb is a global biopharmaceutical company that is focused on discovering, developing and delivering innovative medicines that help patients prevail over serious diseases. Audit Services has a wide mandate – to provide assurance and risk-based insights to the business and its stakeholders, in a highly complex and heavily regulated environment. Like many audit functions, the Audit Services leadership team recognized that as the business evolved strategically, Internal Audit needed to become more efficient and more effective in identifying and responding to risks.

As a result, BMS initiated Project Leapfrog, a multi-year strategic initiative with the objective of using data analytics and visualization tools to transform traditional audit processes. This was a true test of leadership as it challenged the function's historic way of doing

business and required teams to think differently, explore the possibilities, and innovate their approach.

Audit Services had to clearly define a strategic vision that was aligned with the business strategy to secure the investments needed to build advanced analytical capabilities within a function that historically had not been analytics-driven. This required—and continues to require—deliberate, clear communication about the value proposition and benefits to the business. Significant changes in its talent model were also needed. Audit Services hired new and different skill sets, sourced talent from corporate IT, and engaged with co-sourcing providers to compose the team needed to drive its strategy.

Audit Services is already beginning to see payback from its efforts. It is fully integrated and aligned with the

company's enterprise-wide analytics strategy, and is viewed as a thought leader around data governance. Additionally, Audit Services has now conducted analytics-driven audits, which have enabled the function to extract insights from data in a way that increased the overall effectiveness of its audits and the assurance it provides to stakeholders.

With these successes in hand, Audit Services is continuing to demonstrate forward thinking and innovation. The function is investing in analytics capabilities that have enormous potential payback from joining disparate data sets across multiple business processes to uncover deeper insights and drive further value. It is also implementing innovative ways to use analytics to drive its periodic risk assessment, using a hypothesis-based approach to analyze transactional data and identify themes and trends that inform the department's view of risk

throughout the company. Finally, Audit Services is transferring the analytics it has developed to the business, giving business leaders new tools to manage the risk to the organization. Audit Services' transformational analytics strategy, the deeper insights it is generating from the effort, and the value it is adding by transferring capabilities to the business are all steps helping Audit Services to demonstrate its value as a Trusted Advisor to the organization.

Talent

A flexible talent model that emanates from a business-aligned strategic plan and delivers the right resources when needed enables effective leaders to deliver more value. Very effective leaders focus on developing and mentoring talent in order to serve as a source of talent for the business.

A focus on talent is especially important because CAEs told us that talent shortages were the most significant barriers preventing them from increasing their contributions as leaders. And as business transformation continues, more and more new skills are needed.

Our study identified that very effective leaders exhibit two clear talent behaviors that stand out from those of their less-effective peers: a focus on mentorship and talent development for the wider business and the ability to source the right talent to add value when and where it is needed.

Very effective leaders develop their people to become future business leaders. The almost 25-point gap between very effective leaders and effective leaders in this area demonstrates that very effective leaders are committed to building teams of business-minded resources who will

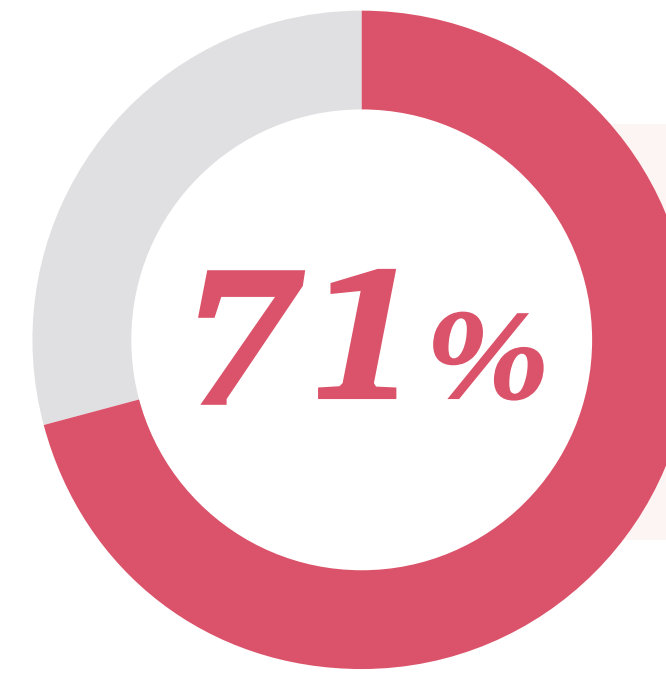


contribute to the talent needs of the wider organization. According to Tom Corcoran, audit committee member at L-3 Communications, “Good leaders attract good people. In turn, good people will be recognized and have the opportunity to advance in the organization.”

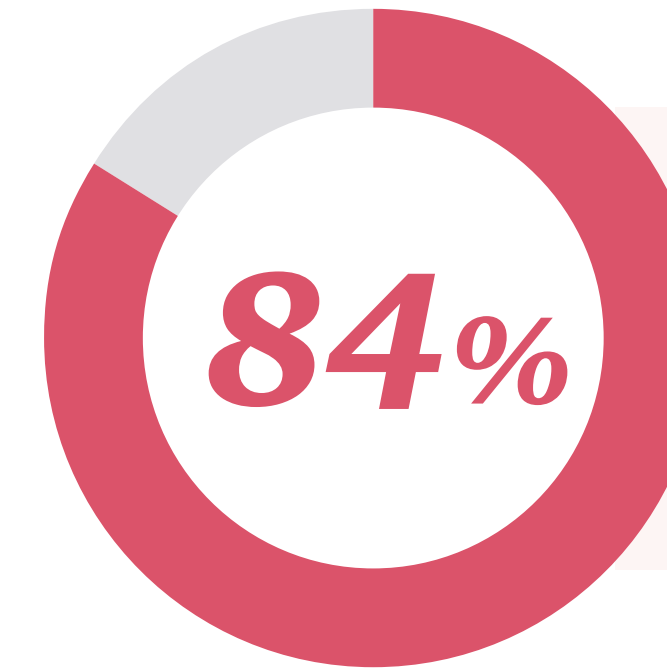
Our interviews identified very effective leaders with policies of “no hierarchy in the room,” which facilitates staff development through open discussion and problem solving as a team. Many very effective leaders told us they often bring team members to executive meetings, which gives staff growth opportunities but also serves to showcase the value of the entire team. Such exposure helps the business identify potential candidates for future positions, because many of those leaders have rotational programs in place and are committed to being a talent source for the business. Others empower staff to self-identify their knowledge gaps and identify creative learning and development opportunities. A review of very effective leaders shows that internal audit functions of any size can bring in

“I definitely see the need for co-sourcing specialized skills – and I see that need in shops ranging from 10 people to 300. In smaller organizations, it is difficult to have all the right skills internally, and in the larger shops, the risks are so complex they need outside help to provide leading-edge expertise and knowledge.”

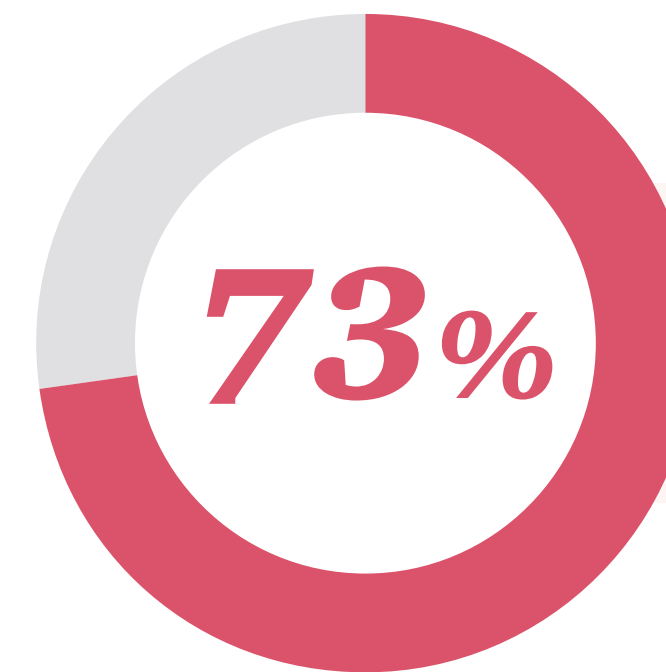
Olivia Kirtley, IFAC President and Audit Committee Chair for U.S. Bancorp and Papa Johns International



of very effective leaders develop people with business acumen to create future business leaders



of very effective leaders are agile in resourcing so as to complement the organization's strategic direction



of very effective leaders cosource to supplement internal talent

high caliber resources, help them learn the business and prepare them for other roles in the organization.

To achieve the flexibility they need, the majority of very effective leaders use co-sourcing as a part of their talent strategies. Almost three-fourths (73%) of very effective leaders co-source to supplement internal talent, compared with 59% of effective leaders and 42% of less effective leaders. Stakeholders told us that very effective leaders are forward-thinking about their talent needs, recognizing they simply can't manage the complexity of their businesses without supplementing their internal skill sets with expertise and additional capacity at the right time. Many use co-sourcing for complex and emerging areas in which they're unable to effectively maintain relevant skills in-house, as well as for more routine areas that don't necessarily develop their staffs' business acumen. In these cases, co-sourcing frees the internal team to focus on areas where they can add the greatest value.

“We use co-sourcing to fill talent gaps as needed. For instance, when Audit Services team members have the opportunity to transfer into the business, we use our co-source relationship to backfill the position on an interim basis. This allows us to still get our work done while enabling our businesses to quickly fill open positions within their organization.”

Mark Bender, Chief Audit Executive, Terex

Questions to consider:

- *When has your internal audit function most recently reevaluated its talent management strategy, and is that strategy discussed with key stakeholders, including the audit committee?*
- *How do the business acumen, skill sets, and professional experience of your internal audit team align with the emerging risks your organization faces?*
- *Does your internal audit function identify or create strategic development opportunities and use mentorship to develop business leaders?*



Striking a talent balance through sourcing: Pinnacle Foods, Inc.

Pinnacle Foods is a leading producer, marketer and distributor of high-quality branded food products. Their diverse product portfolio includes brands such as Duncan Hines® baking mixes and frostings, Vlasic® and Vlasic Farmer's Garden® shelf-stable pickles, Birds Eye®, gardein™, and Van de Kamp's® and Mrs. Paul's® frozen prepared seafood. The acquisition of Boulder Brands added well-known brands such as Glutino®, Udi's Gluten Free®, Earth Balance®, EVOL®, and Smart Balance® to the Pinnacle Foods portfolio. Pinnacle operates with a lean organizational structure, enhancing value by balancing growth in their existing brands and through acquisition-based expansion that complements their portfolio.

Pinnacle's leadership sets the tone for the Internal Audit ("IA") function through the execution of a robust risk management process that identifies the key risks facing the business and directs

the focus of the annual Internal Audit plan. Consistent with this tone, and in order to effectively execute the risk-based audit plan, Pinnacle's IA function is challenged with establishing a structure that provides the right mix of talent and evolving that talent model to keep up with the company's strategic vision and risk profile. To meet this challenge, Pinnacle's Vice President of Internal Audit, Greg Watkins, has found the most effective structure is a balance between an in-house team and a co-source provider. The balance achieved through this co-source arrangement enables Pinnacle's IA function to add value by focusing on the key and emerging risks that affect the business, such as food safety, cybersecurity and social media.

Pinnacle IA has several objectives in creating and executing its annual plan: creating business partnerships to provide insight and recommendations to management to enhance and improve risk

management capabilities and internal controls; delivering value through operational auditing; executing the company's SOX testing; and feeding talent into the business through a rotational development program. Achieving success related to these goals is a challenge in itself, and doing so in a manner that is cost-effective to the organization adds a complexity with which most IA functions struggle. Pinnacle's co-source function is the ideal model to achieve the function's multi-faceted mission of adding value to the business while consistently developing talent.

Pinnacle realizes value from its in-house team, by maximizing staff utilization on operational audit projects and SOX testing throughout the year. The co-source provider delivers IA resources to supplement the existing team to help manage capacity at peak times or during the transition of

internal resources as staff rotates into the business. Additionally, the co-source provider enables Pinnacle to leverage an on-demand specialist network for specific skillsets to support strategic operational audits. The combination of in-house talent and third-party resources enables Pinnacle to keep pace with the business, both in terms of responsiveness and skill set. It also serves as a natural opportunity for staff development, while retaining critical knowledge of the business and key business relationships within the core team.



Comprehensively developing talent for the business: Georgia-Pacific LLC

The internal audit function of consumer and forest products manufacturer and marketer Georgia-Pacific LLC has established itself as a valuable source of talent for the business. The function's intense focus on talent is visible from its recruiting through ongoing auditor development efforts. Providing this talent pipeline is seen as a strategic value driver by senior management.

At Georgia-Pacific, building an internal audit talent model is perceived to be as much art as science. Each time an audit team member moves on in the organization leadership takes the opportunity to reevaluate current needs, capabilities and the organization structure rather than simply backfilling the position. With target skills in mind, the talent search is focused on finding the best talent available with long-term potential for the company. The function will also hire opportunistically when

great candidates present themselves, even if not in the plan. This approach helps support the internal audit vision of protecting existing value and driving future value creation.

Because new hires are unfamiliar with the Georgia-Pacific culture and often come with experience from different industries, there is a strong initial focus on knowledge building and personal development. The onboarding process teaches both audit and business fundamentals with close supervision. Each person's key abilities—such as critical thinking—are quickly identified. Supervisors work with each individual to develop a personal development plan that identifies current skills, skill gaps, training needs and development activities. In addition to performance reviews with immediate supervisors each staff member meets with the CAE periodically during the year to ensure

they are on the right track and that an open dialogue exists within the team.

Internal audit's recently developed Auditor Development Continuum defines expectations for each staff level. It provides a structure for coaching and creates transparency around career paths both within audit and elsewhere in the company. In the past, auditors felt they needed to transfer out of Internal Audit to get promoted. Now each individual is able to define his or her own path, which has helped to retain strong team members and institutional knowledge.

Internal audit's Visiting Auditor Program is also a key means of talent development. Auditors are loaned out on temporary assignment to other parts of the business where they can create a high impact and develop professionally. When auditors do rotate out of Internal Audit after having participated in the Visiting Auditor

Program they are much more prepared to hit the ground running and add value to the business. The program is seen as an attractive opportunity to potential new hires, helping to make recruiting more effective overall. Furthermore, the program has been strategic to raising the business perception of internal audit's value. Stakeholders see first-hand the capabilities of the internal audit team making it attractive as a pipeline of new talent that supports Georgia-Pacific's long-term growth.

Position

Stakeholders acknowledged that organizational positioning can present a circular dilemma. It is certainly far more difficult for the internal audit leader to remain business aligned and contribute to the business's strategic objectives without engaging directly with the organization's executive leadership. At the same time, a senior job title does not itself elicit respect, confer authority, or guarantee influence. Rather, influence must be earned through constant delivery of value.

Our study identified that empowerment by stakeholders is a clear factor in the organizational positioning of very effective leaders. Empowerment is achieved through a combination of factors, including the position the CAE holds in the company, the tone set by stakeholders, and the business acumen of the leader. For example, our data shows that a larger percentage of very effective leaders hold senior positions in their organizations compared with their less-effective peers. A 25-point gap



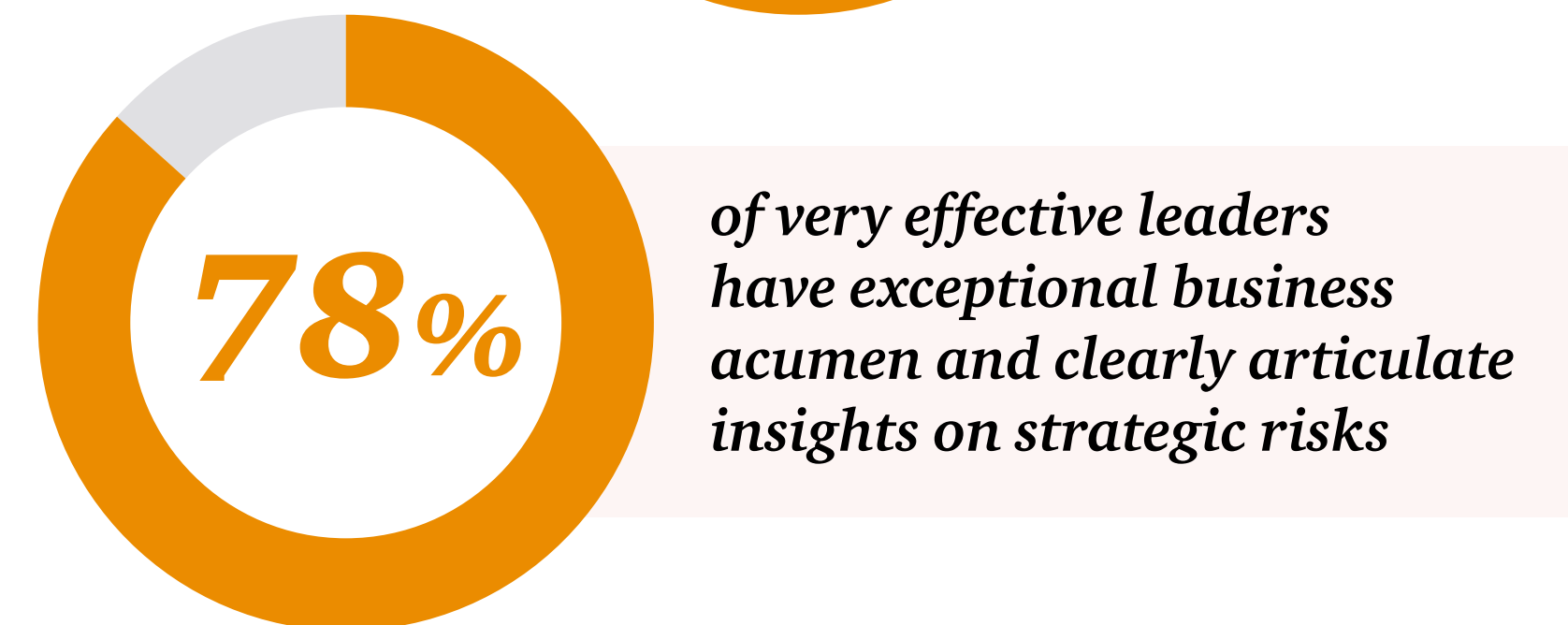
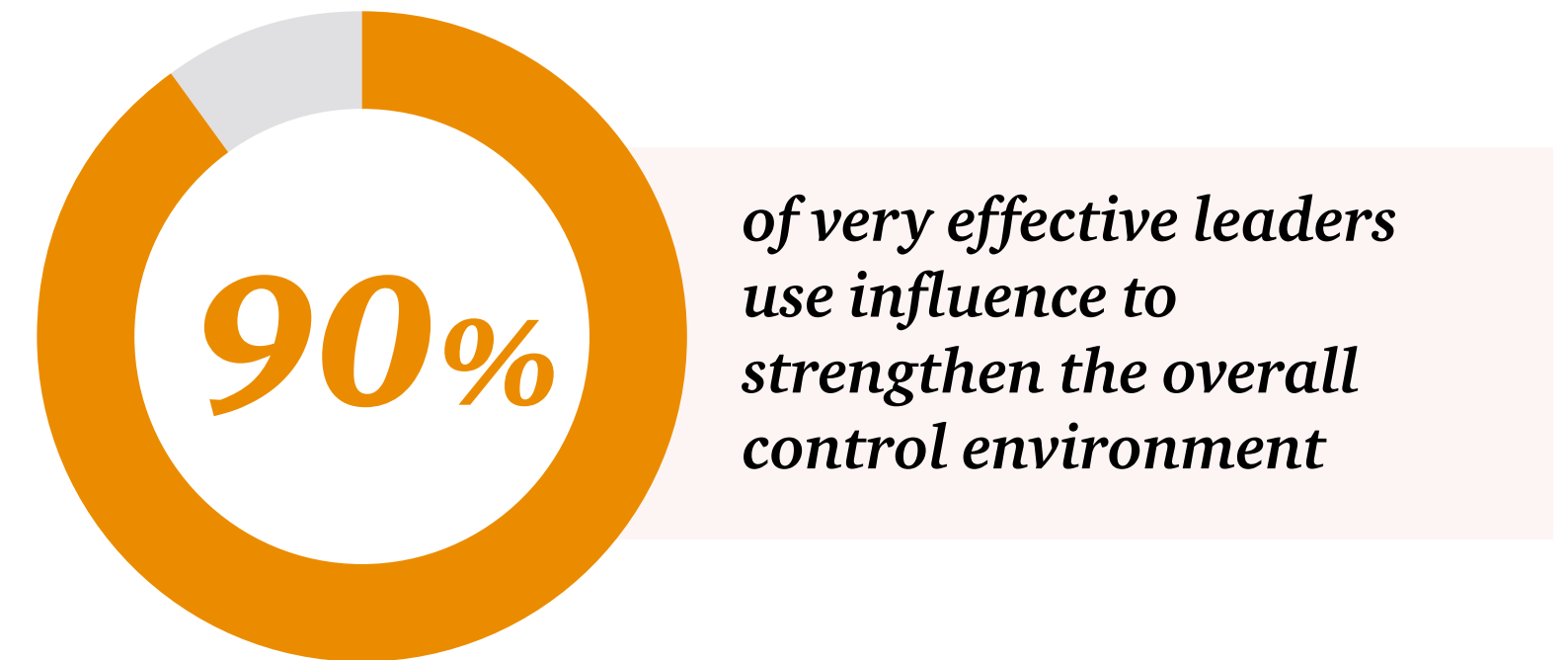
exists between very effective and effective leaders in holding titles of vice president or higher. In some instances, stakeholders told us they needed more from their functions and gravitated toward more-senior leadership talent to fill the CAE role. In other cases, very effective internal audit leaders have been rewarded with a more senior title based on their records of performance at the company.

Further, board members and executive leadership acknowledged their responsibility to empower the CAE by setting a culture that supports the importance of a strong control environment. Executive leadership sets the tone to which the business responds. With the right culture in place, the internal audit leader is more often seen as an influential contributor to those important objectives.

Not all responsibility for organizational positioning lies with stakeholders, however. CAEs should consider what they can do to build stature in the organization and help enable executive leadership to

“The internal audit leader must be someone who commands the same level of respect as the key business leaders in the organization.”

Robert Herz, Morgan Stanley (Audit Committee Chair), Fannie Mae (Audit Committee Member) and Workiva (Director)



set the right cultural tone. For instance, when a CAE's vision is articulated clearly by way of a strategic plan and is communicated with impact, that CAE is more likely to be seen as a peer to business executives. Or, internal audit builds its relevance and value by being proactive in educating stakeholders on emerging risks and risk management best practices that would benefit the business.

Business acumen is also a key contributor to positioning for which the leader can take responsibility. Stakeholders were in agreement that the most important component in the internal audit leader's background is the ability to understand a complex business. Our survey data supports that belief in that 78% of very effective leaders have exceptional business acumen and clearly articulate insights on strategic risks, compared with 47% of effective leaders and 21% of less effective leaders.

With the right positioning, 9 out of 10 very effective leaders are able to leverage their influence to strengthen the overall

control environment. For example, well-positioned leaders are able to comment on the behaviors and culture of the organization, and engage in strategic initiatives at the onset to provide timely advice that allows the business to change course if needed. Rene Pillay, Vice President of Audit at Sibanye Gold Ltd. in South Africa, captured it this way: "If the business sees you as a department they can come to for advice, then you are on the right track."

Questions to consider:

- *What tone do executive leaders set to empower internal audit's role?*
- *Have stakeholders done all they can to empower the CAE to effect change?*
- *What steps has the CAE taken to more deeply understand the business and the industry in which it operates?*

Communication

Stakeholders describe leaders with executive presence as being confident, composed and possessing characteristics marked by authenticity and integrity. Nine out of 10 very effective internal audit leaders excel in demonstrating executive presence, communicating bold perspectives, and thinking broadly about the organization.

A primary means by which very effective leaders establish executive presence is through stakeholder communication. In interactions with stakeholders, internal audit leaders must inform, educate,

and influence stakeholders as well as earn their trust. Without effective communication, internal audit is less likely to gain stakeholders' attention related to issues and root causes; and stakeholders will be slower to effect change.

But internal audit leaders face a specific and difficult communication challenge: they must communicate with a variety of internal and external stakeholders, each with different expectations of internal audit. According to Dan Schurr, Audit Committee Chair at CHS Inc.,

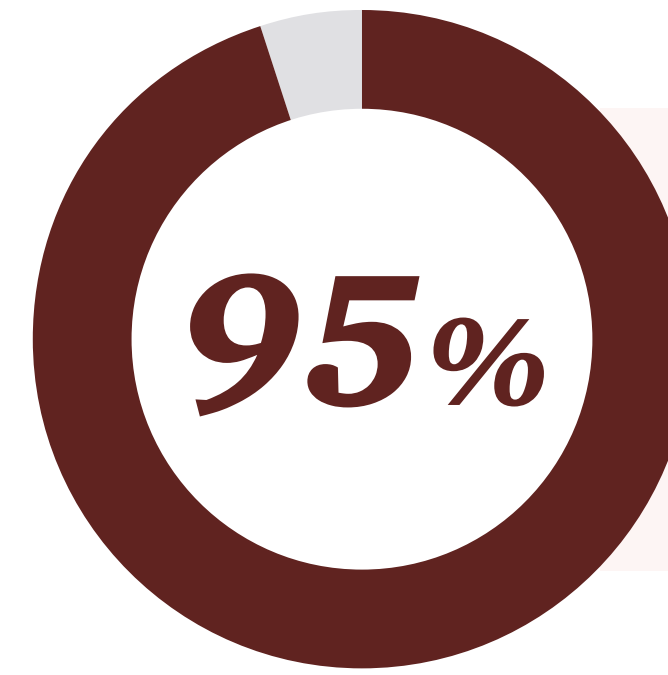


“Communication skills are critically important, in part because internal audit has to explain the value it brings to the company to many different stakeholders that may not have the same view point on internal audit’s value.”

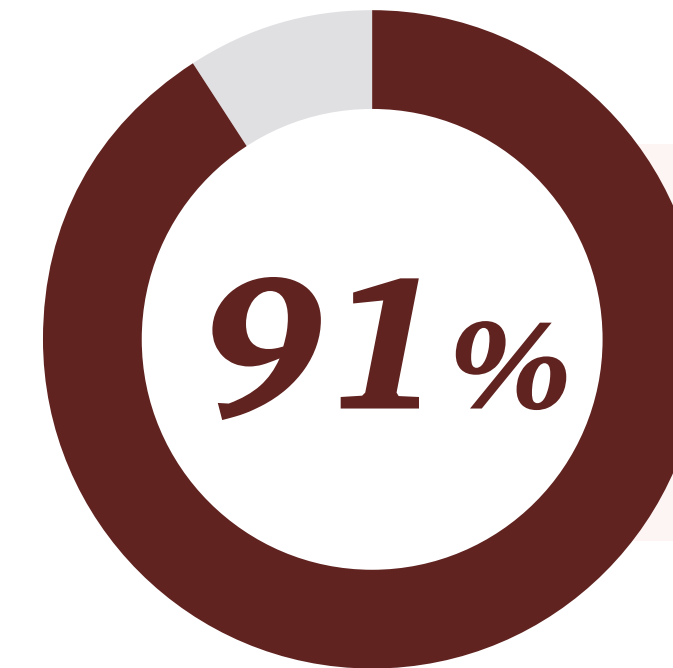
Our study shows that very effective leaders communicate in a concise manner and on a frequent enough basis to result in effective decision making. In fact, when it comes to communication, the difference between very effective leaders and those who are less effective is startling. Whereas just 31% of less effective leaders and 65% of effective leaders are strong communicators, more than 90% of very effective leaders communicate exceptionally well. Very effective leaders set the right communication cadence, provide timely and effective communications (including concise communications enabled by visual reporting and dashboard analytics), and can communicate with impact.

“Value is driven by the internal audit function providing education and meaningful insights to stakeholders on the risks they see, and communicating strategies to better mitigate them.”

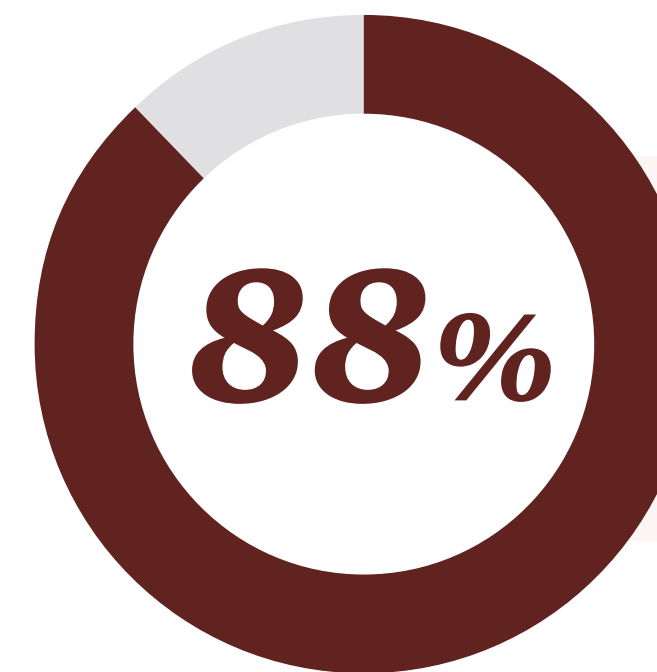
John Hall, MultiCare Health System Audit Committee Chair



of very effective leaders set the appropriate communications cadence with the board and other stakeholders



of very effective leaders provide communications for stakeholders that are effective and timely



of very effective leaders possess strong executive presence and communicate with impact

Simply meeting with the audit committee chair before a meeting is no longer enough. Very effective leaders focus on the quality of their interactions. They communicate with stakeholders outside the context of an audit project or committee meeting so as to provide an informed point of view on emerging risks, offer ideas on the root causes of thematic issues, and help connect the dots on trends. This often takes the form of “board education” or other informative or consultative communications that go beyond the formal reporting of audit results. Very effective leaders have the confidence to routinely solicit feedback from stakeholders to foster continuous improvement. Such two-way communications help facilitate board and management education and understanding, and they also demonstrate the value internal audit is delivering for the organization. Further, they help build relationships that can lead to more-authentic conversations and open lines of communication.

Questions to consider:

- *What additional information does your internal audit function communicate to stakeholders beyond the audit plan and status reports?*
- *Does the CAE establish relationships with stakeholders outside the boardroom? How proactive is the CAE in fostering those relationships?*
- *Does the CAE proactively seek feedback from stakeholders?*



Building security through common controls and clear communication: Adobe Systems, Inc.

Adobe Systems Incorporated is a premier software-as-a-service provider for individuals and enterprises. Adobe's products are designed to leverage the cloud, making a secure infrastructure paramount to success. As part of Adobe's overall strategy to secure its environment, Adobe Internal Audit (Risk Advisory and Assurance Services -"RAAS") led the development of the Adobe Common Controls Framework, a set of controls that were designed to help the organization exceed industry standards and employ leading practices.

Once RAAS had identified the strategic objectives of this critical initiative, Eric Allegakoen, Vice President-RAAS & Chief Audit Executive, led the effort to share with the Audit Committee of the Board of Directors and Senior Management on the benefits of approaching compliance with multiple frameworks using a Common Controls Framework. The Board and Senior Management quickly embraced the idea and then empowered this effort

by communicating their support for the plan to stakeholders, and setting the tone that at the highest levels, Adobe was committed to ensuring its platform is highly secure and supported by a robust technology control environment. Led by Abhi Pandit, Senior Director of RAAS, Adobe's RAAS Group then served as the coordinating body to develop the framework in collaboration with Adobe's business units.

Through a comprehensive review of the relevant industry standards (such as SOX, SOC2, PCI-DSS, GLBA, ISO 27001, and industry-specific requirements such as HIPAA for data privacy in healthcare), the team ultimately established a set of 200 common controls across 11 control domains, which satisfied the more than 1,000 control requirements contained throughout the various industry standards. Now, using the framework, the entire Adobe enterprise follows a Common Control Framework and can

quickly adapt to changes in the standards by updating its controls framework to account for any new requirements.

RAAS was responsible for disseminating the Common Controls Framework throughout the business and is now helping to support the framework through business unit education and testing, to ensure controls are in line with expectations. Underlying their success is a commitment to transparent communication—ensuring stakeholders are getting the information they need when they need it, to take the steps necessary to protect their environment.

Business alignment

Partnering with the business in meaningful ways sets certain internal audit leaders apart. Our study identified that very effective leaders stand out with three specific behaviors: They develop relationships built on trust. They build partnerships across the lines of defense. And they use those connections to raise their level of engagement across the organization.

Very effective leaders make intentional efforts to build relationships with stakeholders outside the normal audit process, which helps them build trust

and better understand what's really happening on the ground. Our study shows there is a more than 20-point gap between very effective and effective leaders in their functions' ability to perform well at engaging and managing relationships with stakeholders. Very effective leaders assign accountability for stakeholder relationship management throughout their teams, making clear that audit staff are expected to expand their business interactions beyond individual audit projects. When that expansion is carried out well, internal audit team members not only increase their

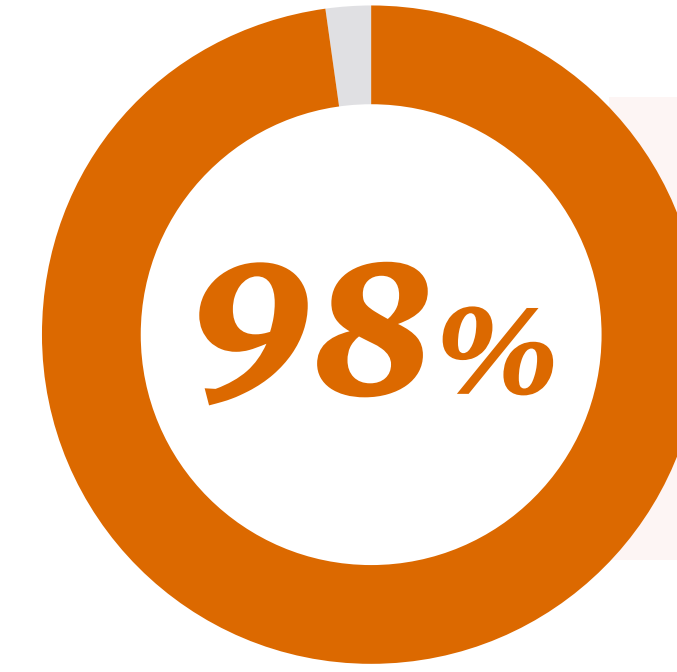


understanding of the business and its risks but also become more responsive in adopting new audit plans and approaches as new risks emerge.

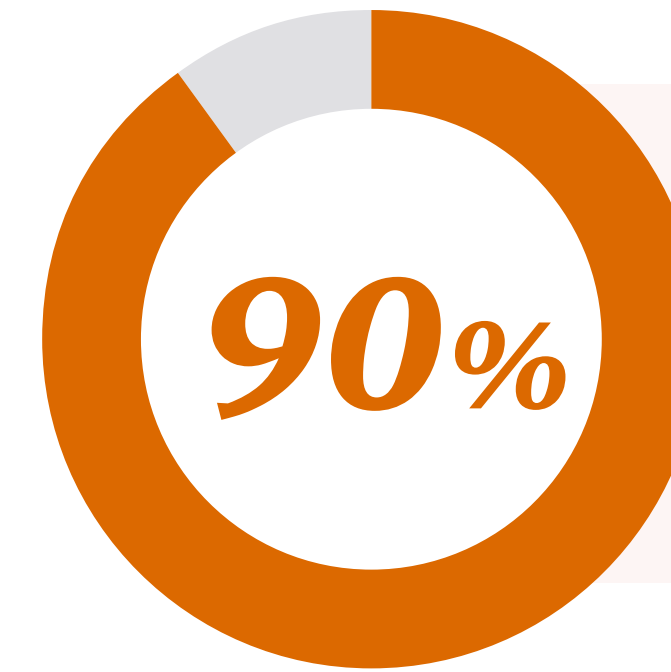
Very effective leaders collaborate across the lines of defense to play greater roles in coordinating risk management across functions. According to Peter Hamilton, Audit Committee Chair at Spectra Energy Corporation and Audit Committee Member at Oshkosh Corporation, “Accountability and authority for risk management have become more dispersed, and as a result, proper coordination among risk management activities has become critical to a successful program.” Very effective internal audit leaders often take on leadership roles in working with management, compliance, legal, and other assurance functions to develop an integrated assurance strategy that ensures that all of them are working in tandem. Several very effective leaders have even intentionally renamed internal audit (e.g., as Audit Services) to brand the function as a collaborative one that partners with the business.

“Very effective internal audit leaders emphasize the importance of cooperation with the business. They must build trust and work cooperatively with the business while of course—and very importantly—maintaining both objectivity and independence.”

**Phil Holzer, Chief Audit Officer,
Bristol-Myers Squibb**



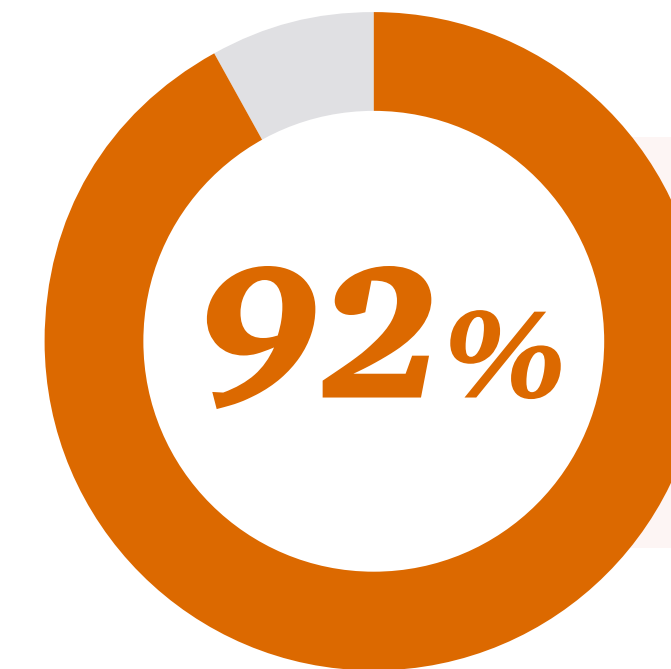
of very effective leaders have internal audit functions that perform well at aligning the scope and audit plan with the strategic direction of the business



of very effective leaders have internal audit functions that perform well at engaging and managing relationships with stakeholders



of very effective leaders are contacted by stakeholders to provide consultative input on the vast majority of—or, sometimes, all—significant business events



of very effective leaders foster continuous improvement and motivate the team to embrace change

Through business partnerships, very effective leaders more naturally stay in tune with what's happening across the business. Such partnerships involve them more often in transformational change ranging from large-scale systems implementations to outsourcing of business processes, or the integration of major acquisitions. In fact, when internal audit leaders have established true business partnerships, the internal audit function is sought out for input far more often. Stakeholders call on very effective leaders to provide consultative input on significant business events at double the rate that they call on less-effective leaders. And through cooperation with other assurance functions, internal audit can help reduce the overall cost of assurance and compliance activities borne by the organization while ultimately lowering the company's overall risk.

Questions to consider:

- *Is your internal audit function optimally aligned with other assurance functions?*
- *Has your internal audit function co-developed a strategy for working with other assurance functions?*
- *How much time has your internal audit function reserved to provide support for its stakeholders both proactively and in response to specific business issues as they arise?*
- *Is your internal audit team expanding their business interactions beyond the audit?*



Revamping risk management through business partnership: Dun & Bradstreet, Inc.

Dun & Bradstreet is a global leader in commercial information with nearly 90% of the Fortune 500 relying on its data, insights and analytics. The company's enterprise risk and audit function is continually looking for ways to drive risk management accountability in every function and business unit across the company. In line with the company's focus on becoming more collaborative, the audit function identified an opportunity to partner with the compliance team to embed the ERM framework into its compliance liaison program.

The first step was for the audit and compliance leadership to engage the board of directors on the recommended approach, which the group saw as enabling the company's new strategy. The second step was to engage each of the CEO's six direct reports to designate a compliance and "risk leader," a senior-level manager who would take responsibility for conducting risk

assessments across the direct report's group, and for ensuring the risk assessments supported decision-making at both the group and enterprise level. The risk leaders would not be dedicated to ERM full-time, supporting the idea that assessing risks and raising them to the right people should just be part of everyone's daily work life. The leaders also created a risk committee that would be responsible for prioritizing risks raised through the risk assessment process. They also worked with the marketing and communications team to spread the word about the new approach to ERM.

To kick off the new process, a week-long workshop was organized to educate the risk leaders and their selected team members about risk management and compliance so they could cascade information out to the larger organization. The training sessions covered ERM tools and techniques, as well as details on specific types of risk. The training included not only many

of the basics of an ERM program, but also information to help teams better understand, prioritize, and then manage specific risks. One surprise benefit of the workshop resulted from just connecting people, which helped participants better understand the issues that each of their groups were facing and that those issues might already have been confronted and solved in another group.

This undertaking maintained the effectiveness of risk management at Dun & Bradstreet during a time of significant change in the company's strategy. Each risk leader now follows his or her own path for risk assessment and presents to the risk committee the risks that the assessment has uncovered, along with suggestions on ways to mitigate those risks. The risk committee looks at each exposure from different angles to understand whether there might be additional consequences that the risk leader hadn't considered. It helps prioritize risks at an enterprise level,

and ensures the risks are leveraged as input into processes such as SEC reporting, strategic initiatives, and audit considerations. It also flows information back to the operating teams about the company's enterprise-level risks.

Reaction from the business units has been overwhelmingly positive. Business units feel empowered to look at and respond to risks that might prevent them from achieving their objectives, and to maximize opportunities. Proactive conversations about risk are now commonplace at every level of the company. The leaders also own communications around compliance and risk to build upon Dun & Bradstreet's risk-aware culture. As stewards of the enterprise-level process, the audit team has much more risk intelligence, helping the team to develop a more robust audit plan to address the company's most critical risks.

Bringing it all together

Our study shows that five characteristics—vision, talent, positioning, communication, and business alignment—are far more prevalent in very effective internal audit leaders than they are in their less-effective peers. The five characteristics are closely interconnected and together enable internal audit leaders to bring elevated levels of relevance and value to their business.



It is through close alignment with stakeholders that internal audit can develop a clear vision for the function. A clear vision drives a business-aligned strategic plan that serves as the roadmap for meeting an organization’s ever-changing needs. A sophisticated approach to talent sourcing and talent development gives internal audit leaders the flexible talent model needed for accessing subject matter expertise, for generating deep business insights that include an understanding of the ultimate root causes of issues, and, ultimately, for seeding the business with highly capable, controls-minded talent. A steadfast vision paired with effective communication builds influence and executive positioning, which in turn help internal audit remain

business aligned and engage stakeholders in value-adding relationships. Business partnership and effective communication help the organization recognize and understand current and emerging risks and proactively address thematic issues. As a result, 96% of very effective leaders inspire stakeholder trust and confidence that risks are covered, which is risk management functions’ ultimate responsibility.

“The attributes of an effective leader are interdependent. One can’t be a talent manager without vision—or build strong business partnerships without executive presence. Being a consummate leader not only requires strength in each and every one of these attributes but also the self-awareness to recognize the limits of their capabilities and then obtaining additional capacity and capabilities from experienced third-party providers where required.”

Richard Chambers, Institute of Internal Auditors President and CEO

Figure 7: Correlation between value and leadership

	Percent of leaders considered strong in each trait	
	<i>Very effective leaders</i>	<i>Effective leaders</i>
Vision	89%	64%
Talent	76%	53%
Position	82%	54%
Communication	91%	58%
Business alignment	95%	69%
Internal audit contributes significant value	92%	52%

Source: 2016 PwC State of the Internal Audit Profession Study

Making it happen




As the business environment rapidly changes and as stakeholders expect more and more from internal audit, managing and navigating internal audit's course have become challenging tasks. Standout leadership is essential.

Our study clearly correlates very effective leadership to internal audit value contribution and performance and further explains how more advanced leadership behaviors contribute to value. Both internal audit leaders and their stakeholders can take immediate and specific actions to bolster internal audit leadership effectiveness (Figure 8). Internal audit leaders should acknowledge the impact of their leadership on the function's effectiveness and on stakeholders' perceptions of value, and they should use the tools communicated in this paper to strengthen their own leadership credentials. Meanwhile, stakeholders should recognize the effect of leadership on the performance of their internal audit functions and support the development of their leaders. That includes challenging

leaders to set performance objectives around the five internal audit leadership characteristics detailed in this study and endorsing internal audit leaders as they engage in the behaviors underlying those characteristics.

By honestly assessing and prioritizing internal audit leadership, an organization can set a course to ensure it has the leadership needed to meet stakeholder expectations now and to guide the organization into the future.

Figure 8: Actions to take now

	Chief Audit Executives: Lead	Stakeholders: Enable
 Vision	Develop and share a vision for your function, aligned to the strategic objectives of the business and determine what is needed to get there, including resources and technology.	Hold your internal audit leader accountable for aligning internal audit with the business strategy.
 Talent	Make certain your talent model can respond to the organization's emerging risks by mentoring and developing future business leaders and supplementing the core team with outside resources.	Ensure you have fully communicated your expectations around internal audit talent and its potential value to internal audit and the broader stakeholder group.
 Position	Consider whether you are taking enough action to build your stature in the organization and creating a platform for executives to empower you.	Revisit whether you have done enough to empower the internal audit leader, including setting the tone for the organization around controls and proactive risk management.
 Communication	Challenge whether you are communicating with enough impact to get the attention of your stakeholders and influence results.	Provide feedback to help your internal audit leader maximize the impact of his or her communications and optimize the use of your time.
 Business alignment	Build trusting relationships throughout the business to raise your level of engagement across the business.	Be open to working in a consultative way with your internal audit function and let them know when and where you expect more.

Appendix: About the Research

The 2016 State of the Internal Audit Profession Study combines qualitative and quantitative research. An online survey generated response from 1,679 executives, of whom 58% were internal audit leaders and their direct reports and of whom 42% held management or board titles. Participants spanned a wide array of industries, geographies, and company sizes.

To gather qualitative data on the topic of leadership, PwC also conducted one-on-one interviews with nearly 100 stakeholders and chief audit executives across North America, Europe, and Asia. In addition to reviewing those interviews in detail, PwC used a tool that enables analytics on unstructured data to identify the frequency of keywords and themes across the interview set.

We thank all of the executives who gave their time to provide added insight for this year's study.

To have a deeper conversation about how this subject may affect your business, contact:

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