Vertical change

How internal audit can help avert crises, envision the future, and "make magic"

In April 2016, Deloitte hosted its second annual **Global Chief Audit Executive Forum,** a two-day event at Deloitte University in Texas, featuring keynote speakers, workshops, analytics and visualization demonstrations, and innovation sessions. Chief audit executives (CAEs) from select organizations were invited to participate in the event with the objectives of gaining new perspectives, ideas, and inspiration. This article offers some of the insights gleaned from the event.

“Playing it safe can be dangerous.”

So claimed Magnus Lindkvist, futurist and business analyst, at Deloitte’s recent *Chief Audit Executive Forum.*

In support of his assertion, Lindkvist cited examples from the disparate worlds of American football and motor vehicles. The introduction of safety equipment—helmets in the former and seatbelts in the latter—can be associated with an increase in concussions and accidents respectively, perhaps because the protections lulled the occupants into a false sense of security.

The lesson? Don’t be deceived into thinking the cautious path you are following will lead you safely to your destination.

Success: rent or own?

Consider the rags-to-riches-to-rags case of a Northern European company that earlier this century dominated the mobile phone marketplace. The company has a household name, but its history is less well-known. It began in 1865 in the business of paper manufacturing, pivoted into wire and cable, and then expanded into rubber, plastics, and even gas masks, before attaining phenomenal success in smartphone manufacturing.

Throughout its history, the company innovated relentlessly and experimented boldly. But in the 21st century, the company narrowed its focus, divesting itself of many business lines to concentrate on telecommunications. The strategy worked initially: for a time, the company was the largest vendor of mobile phones in the world.

But soon the company’s product was overshadowed by Android and Apple devices, and its mobile division was ultimately sold. At the time of the sale, the market share of this one-time behemoth had decreased to just 3 percent of the global smartphone market. As reported by the *New Yorker*, “this was, in retrospect, a classic case of a company being enthralled (and, in a way, imprisoned) by its past success. … [The company’s] failure resulted at least in part from an institutional reluctance to transition into a new era.”

The takeaway? Successes can be rented but never owned. You have to keep moving.

Vertical vs. horizontal change

The case for change is well-established and accepted in business theory and literature. Products, services, markets, and customers all evolve over time, and companies must do likewise to keep up.

This theme recurred frequently during the 2015 edition of Deloitte’s CAE Forum, encapsulated in the terse phrase, “Adapt or die.”

That stark statement was slightly tamed for last year’s post-event report, “*Adapt or disappear*,” which argued that “Top executives—and those who advise them—must understand the inevitability of exponential change and the fact that their organizations will be significantly impacted.”

At this year's CAE Forum, guest speaker Lindkvist took that concept a step further, noting that all change is not created equal. Many companies engage in horizontal change when in fact, vertical change is required for successful adaptation.

Lindkvist explained that horizontal change manifests itself in several ways:

- the tendency of companies to do the same thing in more places. For example, a German auto manufacturer expands its sales and marketing to China.
- the proclivity to create "new" products within existing lines. For instance, a global confectioner known for its colorful, bite-size candy recently added three flavors to its "plain and peanut" lineup—coffee, honey, and chili. An example of bold product development? Or more of the same?
- the appearance of "R&D" in strategy plans. But in this case, said Lindkvist, R&D stands for "rip off and duplicate."

Standing in stark contrast is the notion of vertical change. What characteristics define it?

"Making magic," said Lindkvist.

Perhaps "making magic" doesn't sound like a traditional prescription for business success, but Lindkvist, an ardent believer in vertical change, revealed the magic potion's ingredients:

1. **Look for secrets:** Actively avoid trends and "group-think," which can suppress creativity. Instead, ponder the mysteries. According to NASA scientists, only 5 percent of potential knowledge has been tapped by humankind—leaving plenty of territory to explore. Include unconventional thinkers on your teams.
2. **Experiment:** Don't assume the future will be an application of previously known knowledge. Test limits; challenge assumptions; act boldly. "More of the same" yields nothing but greater quantities of sameness.
3. **Be patient:** Don't be afraid to fail—it's a necessary step toward success. Cultivate productive failure; draw and share lessons from each attempt. Adopt a positive mindset: it's not actually failure; it's "pre-success."

The concept of vertical change applies both within and outside internal audit. Just as the organization as a whole must adapt or disappear, so too must its internal audit group.

The internal audit function must envision and embrace the future to remain relevant. It must apply its analytical and creative talents to itself and to the organization it serves so that both can avoid complacency in success and remain unrelenting in the drive to innovate.

But even as internal audit applies the principles of vertical change to its own shop, it must be aware of the need to take its stakeholders along for the ride. Making changes that allow internal audit to work better, faster, and more impactfully is positive only if the company is aware of, prepared for, and desirous of that change.

Crises averted

The mettle of internal audit is never more tested than during a corporate crisis. According to 2016 CAE Forum speaker David Viles, major incidents such as cybersecurity breaches, corporate fraud, or product recalls can spur profound soul-searching and a compelling case for change.

During his career as a partner in professional services firms and in leadership positions in corporate internal audit functions, Viles has carefully studied many corporate crises and concluded that, despite the seemingly spontaneous nature of many calamities, "A large percentage of corporate crises are foreseeable."

At the root of many crises, said Viles, there seems to be some sort of failure in operational discipline—the absence of simple and clear requirements that guide employee actions and behavior; or the failure of management to hold people to account. To help embed and check operational discipline, internal audit should spend less time auditing numbers and more time auditing culture, he said.

A key question helps provide focus: "What do people do when no one is watching?" Internal audit can help ensure the answer is, "the right thing," by taking steps to tilt the playing field, making the easiest thing to do also the right thing to do.

Auditable steps in that direction?

- **clear job descriptions** with simple, straightforward requirements
- **trained, qualified, capable staff** who are held to account for their actions
- **compensation, promotion, and recognition policies** that reward the desired behaviors
- **consistent messaging** that starts at the top of the org chart and filters through the organization without compromise by the "muddle in the middle"

While a crisis provides a unique opportunity for internal audit to make a real and lasting impact on an organization, providing focus and funding that might otherwise be unavailable, a crisis is not a prerequisite for change, said Viles. A compelling case can be made that a crisis averted has as much, if not more, value than fixing a full-blown calamity. Forward-thinking chief audit executives will sell the vision that their organization can realize the gain without suffering the pain by providing their stakeholders with the knowledge that operational discipline and the right culture are alive and thriving in the critical areas.

Envisioning internal audit of the future

With Lindkvist's thoughts on vertical change and Viles's ideas on operational discipline firmly in mind, the 2016 CAE Forum participants brainstormed about the future and internal audit's role in it. Attendees were asked to complete the phrase, "Wouldn't it be great if in the year 2020 the internal audit function ..."

Nearly a dozen statements were generated, after which participants prioritized the top four to be explored in depth. Here are some key findings from that exercise.

Wouldn't it be great if internal audit ...

... **had innovative staffing models and became a magnet for talent?**

In some cases, internal audit shops either have an uneven mix of skillsets or a poor image that impacts recruitment and effectiveness. Not perceived as a rung on the ladder to success, internal audit may struggle to attract and retain top talent.

To counter this, take steps to make internal audit the developer of top talent for the organization. Consider forming ambassador and alumni programs that promote your internal audit "brand" within your organization. Leverage internal organizational marketing and branding specialists to help develop and portray the desired internal audit brand. Adopt a marketing mindset that celebrates success and repositions internal audit as a career accelerator. Develop a catchy elevator pitch that all internal audit team members can use when presented with the questions, "You're from internal audit? What does internal audit do?" Create a rotation program that cycles top talent through the unit in a structured fashion. Liaise with HR and partner with C-suite executives to secure and demonstrate top-level support.

... could anticipate risks over the horizon?

Nothing would endear internal audit to management and the audit committee more than foresight and risk anticipation that not only keeps the organization out of trouble but also maximizes the potential of calculated risk-taking for reward. Helping the business flourish raises the stock of internal audit, giving the CAE the coveted ear of management and seat at the table.

Risk anticipation takes commitment, structure, and investment. Start by networking with your counterparts in the business community. Join trade associations; get risk on the agenda; share best practices; benchmark against your peers. Strengthen internal ties with your risk management function—they may have a structure in place and data on hand that can be leveraged. Invest in predictive analytic and risk sensing technologies that put rigor and process behind your efforts. A single crisis averted or opportunity capitalized upon will justify the investment.

… delivered powerful and insightful communications?
Do the eyes of your audit committee glaze over during your PowerPoint presentations? Could your “pre-read” meeting materials be more accurately labeled “never read”? Perhaps your communications approach needs a rethink.

Start by reconsidering your reports from the perspective of the audience—the subset of information they need vs. the full spectrum of information you have. As you develop each report or presentation, create a synopsis—what are the key points you would articulate if you only had 30 seconds? Reach out to your communications and marketing team for help with your communications; they are the experts and will be happy to help hone your reports and bring them to life. Bring non-finance professionals into the boardroom—engineers, environmental scientists, risk specialists, and others who can bolster credibility and frame the message effectively. Move beyond flat and static reports and decks; use visualization tools and infographics to make your findings more meaningful and accessible.

… utilized analytics and technology to transform?
Many CAEs grapple with the dilemma of doing more with less or at least more with the same. Even as budgets remain flat or are cut, the mandate and expectations for internal audit grow. Yet these seemingly irreconcilable goals can be achieved through the intelligent harnessing of technology.

Paradoxically, this initiative begins not with technology but with people. Expanded skillsets and fresh perspectives are required to move from auditing the past to anticipating the future; consider hiring fewer check-the-box and more outside-the-box thinkers. Sophisticated tools need not break the bank; many capabilities reside untapped in existing enterprise systems—leverage enterprise tools, licenses, and training before spending anew. In the end, you’ll enable insight-driven audits that require less fieldwork and reporting and more planning; you’ll generate smarter and better insights for the business.

Vertical change
There’s nothing magical about “making magic.” Even a sorcerer relies on a recipe to fill his bubbling cauldron.

Transforming internal audit from a horizontal construct—doing more of the same—to a vertical construct—pushing boundaries, envisioning the future, providing more value and actionable insights to the business—requires a shift in mindset and culture.

Traditional skills and backgrounds must be augmented with a broader spectrum of talent. Old approaches and assumptions must give way to bold thinking. Internal audit can no longer play around the edges; it must elbow its way into the game, force the action, and drive the outcome.

The success of the organization—and the relevance of internal audit—hangs in the balance.

Global Internal Audit Leadership

Terry Hatherell
Global and Americas
Internal Audit Leader
thatherell@deloitte.ca

Peter Astley
EMEA
Internal Audit Leader
pastley@deloitte.co.uk

Porus Doctor
Asia Pacific
Internal Audit Leader
podoctor@deloitte.com

Sandy Pundmann
United States Internal Audit Leader
spundmann@deloitte.com

Sarah Adams
Global IT Internal Audit
Audit Leader
saradams@deloitte.com

Neil White
Global Internal Audit
Analytics Leader
nwhite@deloitte.com