

*Internal Audit State of  
the Profession 2013  
Reaching greater heights: Are  
you prepared for the Journey?*

**May 2013**

*US Industrial Products Sector Report*

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# *Agenda*

1. Background & executive summary
2. The issues and opportunity
3. The path forward

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# *Background & executive summary*

# At a glance

- **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 key purpose of this discussion document is to provide select detailed results for your industry compared to the internal audit profession as a whole



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## ***At a glance – US Industrial Products responses***

***Over 1,700 respondents...***

**382 respondents  
from US Industrial  
Products industry**

**58% of respondents  
from the US Industrial  
Products industry were  
CAEs**

**70% of US Industrial  
Products respondents  
reported >\$1 billion in  
revenue**

# ***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

## **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***

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# *The issues and opportunity*

# ***Key theme – stakeholder disconnect***

Across all sectors, stakeholders are not aligned on the internal audit's value, performance, and critical risks to the organization

## **Value**

At the most fundamental level, stakeholders have significantly different expectations of internal audit value

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

One root cause may be that the board is governance focused with lower expectations of internal audit while management expects / wants value

## **Performance**

This year's research confirms that strong performance in the eight core attributes directly correlates to greater value. The largest gaps in performance:

- *Delivering cost effective services*
- *Delivering services with a service oriented team*
- *Aligning scope with stakeholder expectations*

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

## **Critical Risks**

Stakeholders are not aligned on critical risks facing the organization which creates challenges for internal audit in addressing those critical risks

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

Our data points to lack of risk management coordination and integration as a root cause

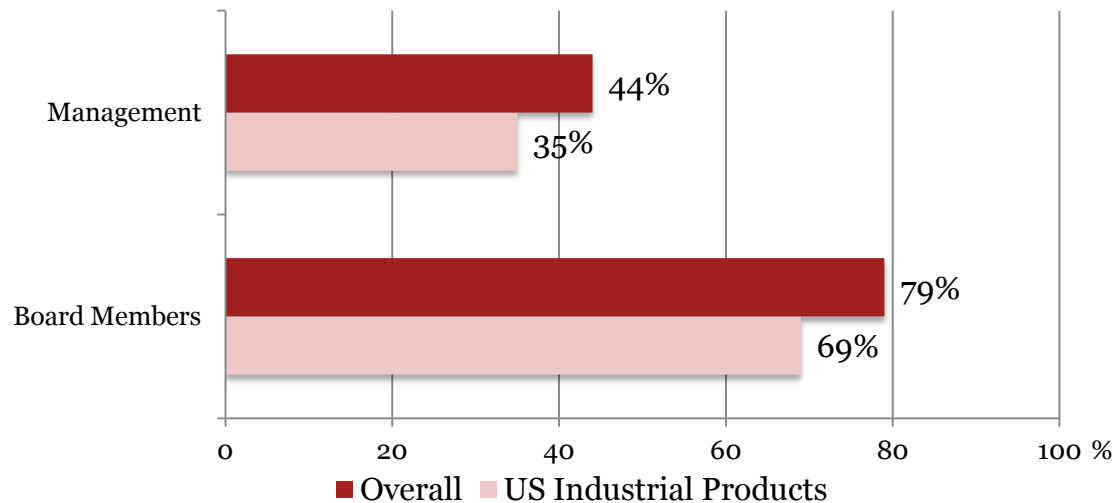


# *Value*

# ***Demonstrating value***

Similar to other sectors, US Industrial Products internal audit continues to struggle to demonstrate its value to stakeholders

**Considering your investment in internal audit resources and funding, please rate the value you receive from your internal audit function:**



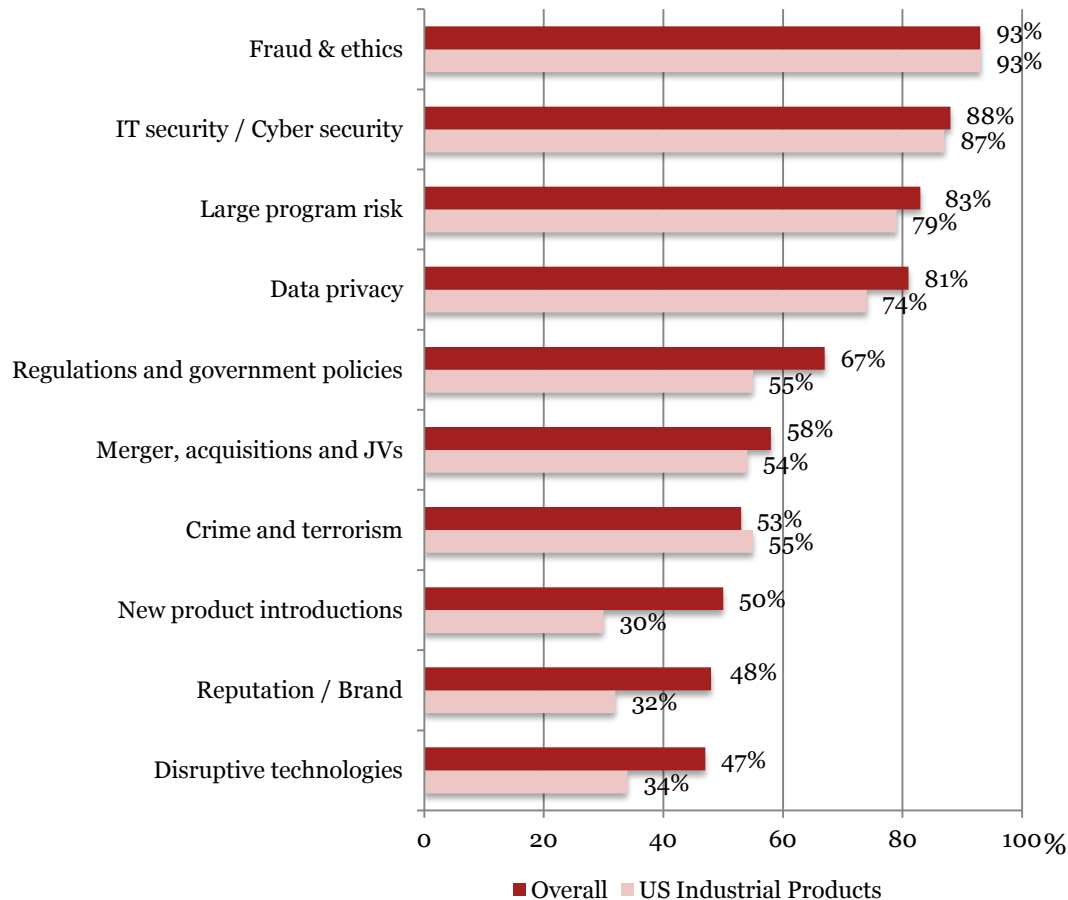
## **Adding value**

- What activities have you undertaken to understand stakeholder expectations?
- How have you collaborated with other risk management functions (e.g. compliance, regulatory, legal, quality)?
- What role are you playing in transformation and strategic initiatives (e.g. project assurance role, controls role, advisor)?

# Aligning to the most critical risks

Compared to other sectors, US Industrial Products internal audit appears to be focusing on a number of critical risks

Internal audit been more involved in this area in the last year



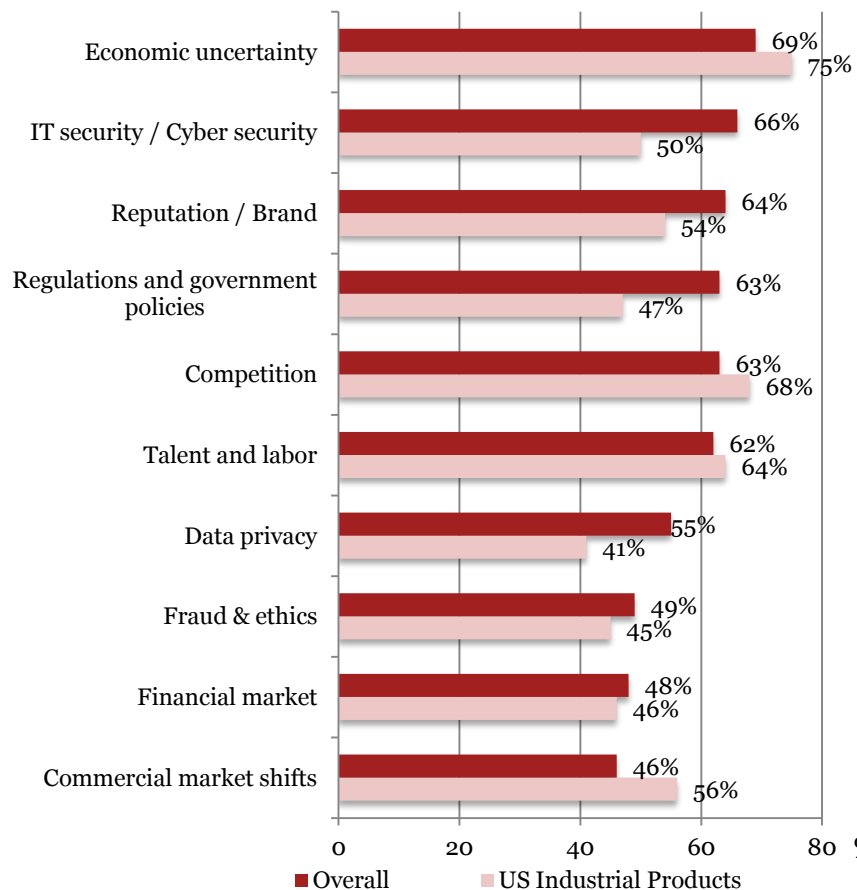
## Internal audit's role in critical risk areas

- How are you monitoring and communicating emerging risks relevant to the organization?
- Are you being engaged early or being brought to the table late?
- What role are you playing in some of these key risk areas (e.g. sitting in meetings, advisor, assurance role)?
- What value are you delivering to your stakeholders through this involvement?

# Aligning to the most critical risks

While US Industrial Products internal audit is involved in many critical risk areas, it should continue to assess the role it can play in traditionally “non-auditable” risk areas

Risks rated as critical to the organization

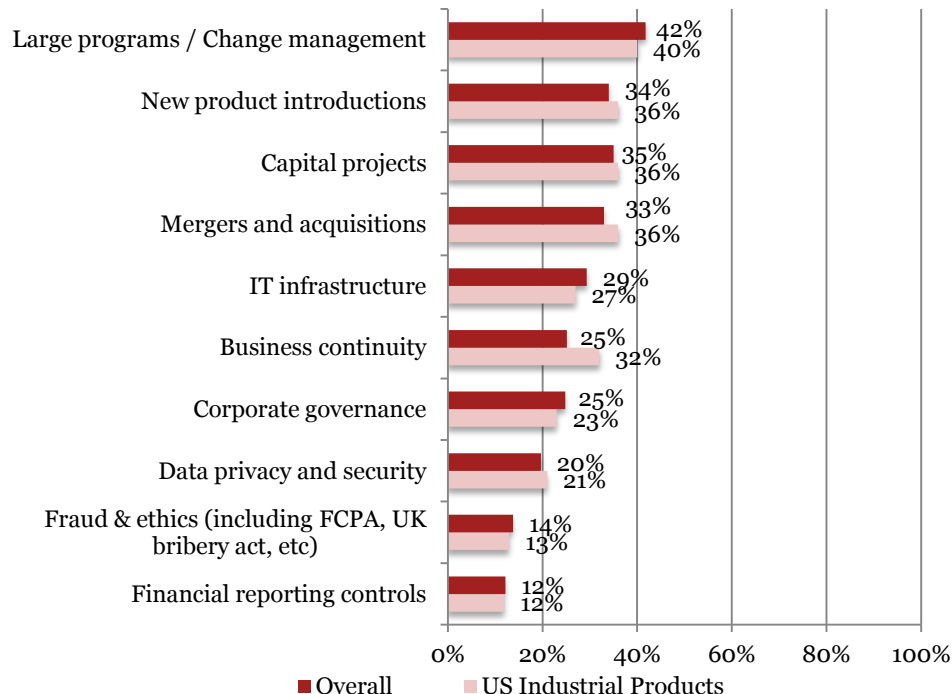


Percent	Critical risk	More involved than a year ago
	US Industrial Products	US Industrial Products
Competition	68	14
Commercial market shifts	56	14
Crime and terrorism	14	55
Data privacy	41	74
Disruptive technologies	31	34
Economic uncertainty	75	20
Energy & commodity costs/prices	62	29
Financial market	46	27
Fraud & ethics	45	93
Geopolitical	29	17
Gov spending & taxation	35	13
International trade & payments	29	44
IT security / Cyber security	50	87
Large program risk	42	79
Merger, acquisitions and JVs	37	54
New product introductions	33	30
Public infrastructure	21	13
Regulations & gov policies	47	55
Reputation / Brand	54	32
Talent and labor	64	40

# Successfully engaging in key risk areas

Broadly, internal audit has increased focus in areas outside of traditional coverage (e.g. large programs, new product introductions); however, stakeholders are least satisfied with these areas – US Industrial Products saw a similar trend

Please rank the three areas where you are least satisfied with internal audit's contribution:



Percent of Stakeholders who ranked this area in the top three areas of dissatisfaction

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

## Playing a meaningful role

- What is driving the dissatisfaction?
- Are you being engaged early or being brought to the table late?
- What role are you playing in some of these key risk areas (e.g. sitting in meetings, advisor, assurance role)?
- How are you structured / staffed to address the critical risks?

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## ***Expanding involvement in critical risk areas***

With the rapid pace of change in the sector, the time is now for internal audit to align and focus efforts around critical areas

### **Key industrial products initiatives / risk areas – is your function involved?**

- Emerging market expansion
- Large program / change management (ERPs, capital projects, etc.)
- Fraud and Ethics (including FCPA, UK bribery act, etc.)
- IT security
- Data privacy
- Social media
- Regulation and government policy (conflict minerals, etc.)
- Talent and labor

# *Performance*

# Improving performance across three key areas

Stakeholders and CAEs all agree that internal audit can improve in the following areas – here are some examples of how to address the issues at hand

## The problem

**42%** of US Industrial Products CAEs believe they bring quality improvement and innovation vs. **22%** of management and **54%** boards

Only **10%** of internal audit functions use analytics regularly, this increases to **14%** for US Industrial Products, overall **71%** lack a plan, this decreases to **66%** for US Industrial Products

Just **one-third** of overall respondents and US Industrial Products said internal audit was doing well in sourcing and training the right level of talent.

## Ideas for problem resolution

### Providing quality improvement and innovation

- Identify / share leading practices across the organization
- As organizations evolve to address new requirements, help to assess emerging risk and identify ways for functional areas / business units to address the risks in a way that makes sense for the organization

### Leveraging technology

- Assess where your function is today from a data analytics standpoint, determine where you want to be, and develop a strategy and roadmap to get there
- Consider investment in resources and process / technology to deliver more value to the organization

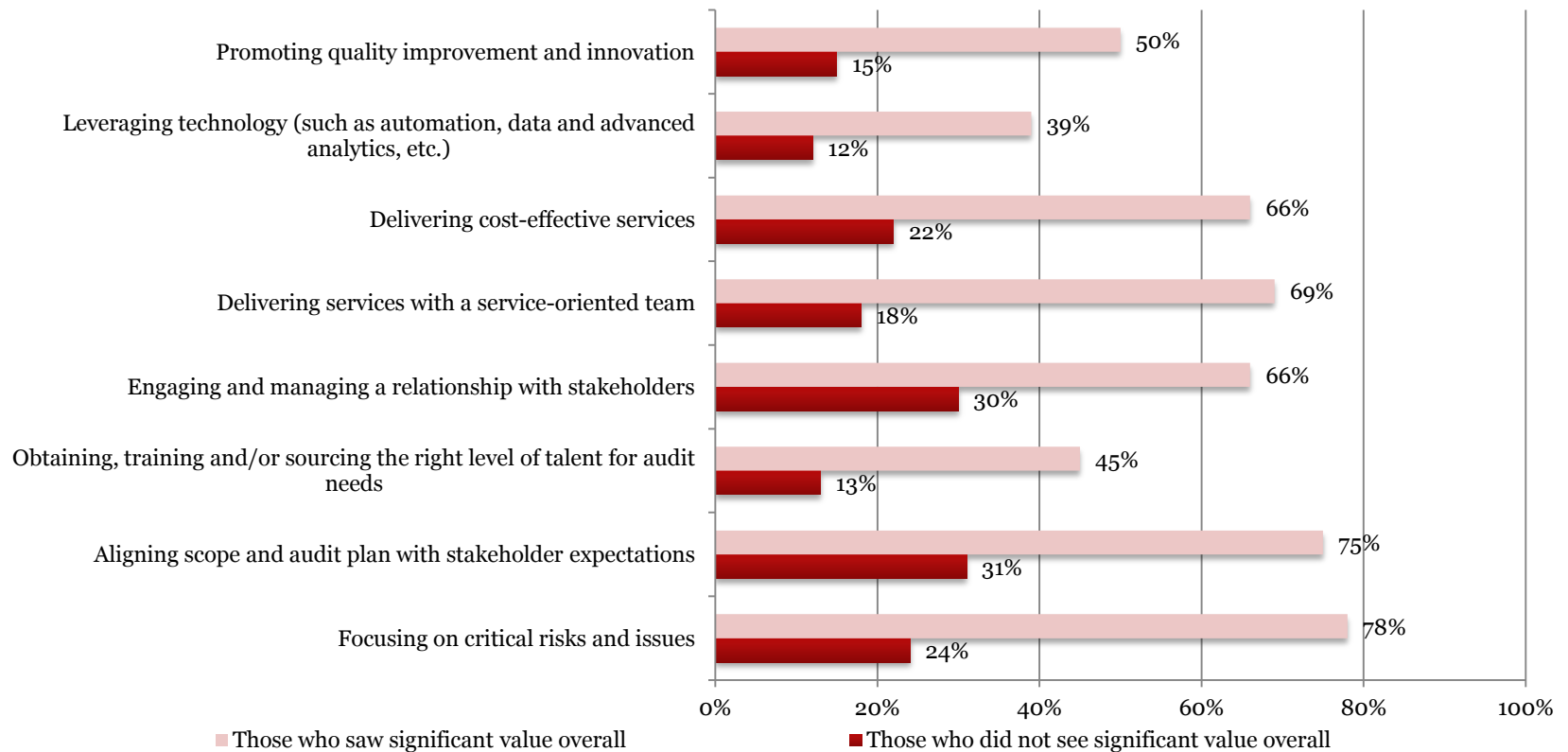
### Bringing the right talent to the table

- Critically assess the talent needed to address the current and emerging risk profile of the organization
- For critical / key areas, determine the internal audit talent strategy - build, borrow, or buy – to optimize or supplement the existing resource pool



# Benchmarking performance against leading departments

High-performing departments also struggle in these three areas – how can you improve to enhance performance in the eyes of stakeholders?

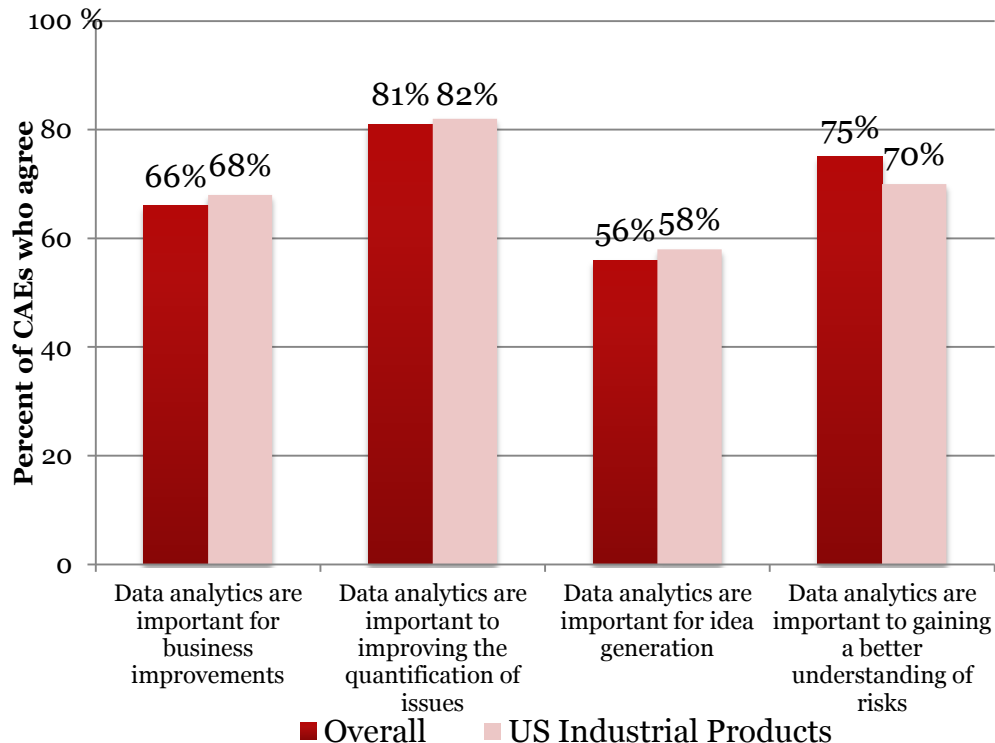


**Percent of stakeholders who say internal audit performs well or extremely well**

# Leveraging analytics

Despite the value that data analytics can provide, many US Industrial Products internal audit functions continue to struggle with implementation

**CAE thoughts on how important are data analytics in strengthening the posture of internal audit with the business through the creation of new and insightful information?**



Only **10%** of internal audit functions use analytics regularly, this increases to 14% for US Industrial Products, overall **71%** lack a plan, this decreases to 66% for US Industrial Products

**47%** of US Industrial Products respondents cite inefficient data collection processes as a barrier

**42%** of US Industrial Products respondents have difficulty finding the capabilities and resources to support analytics

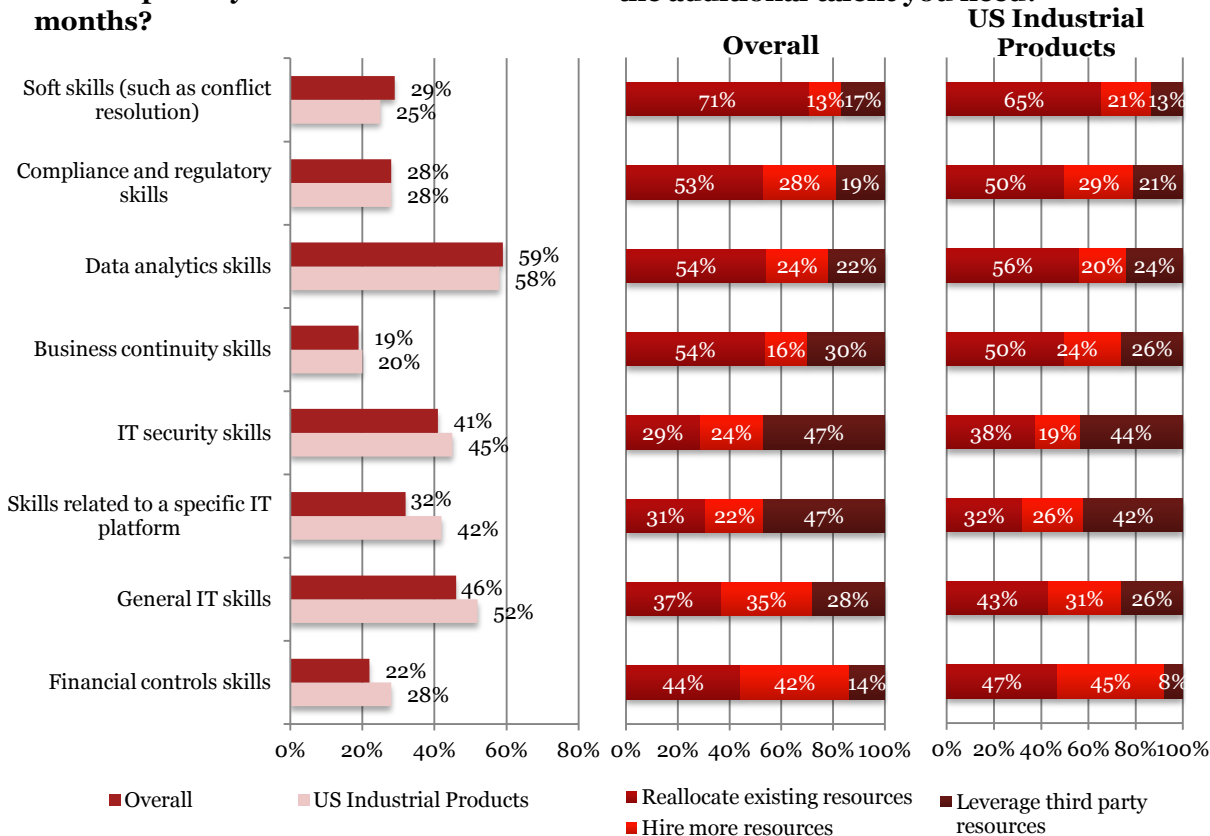
# Closing the capabilities gap

As expectations for standards of performance continue to rise, internal audit must close the capabilities gap

For each area, will you add internal audit capability over the next 18 months?



For each area, where will you most likely get the additional talent you need?



## Closing the gap

- What skill sets are you seeking for your department?
- How do you plan to fill the gaps?
- Consider: sourcing, guest auditor programs, rotation, etc.
- If you plan to reallocate resources, how will you ensure they have the right skills?

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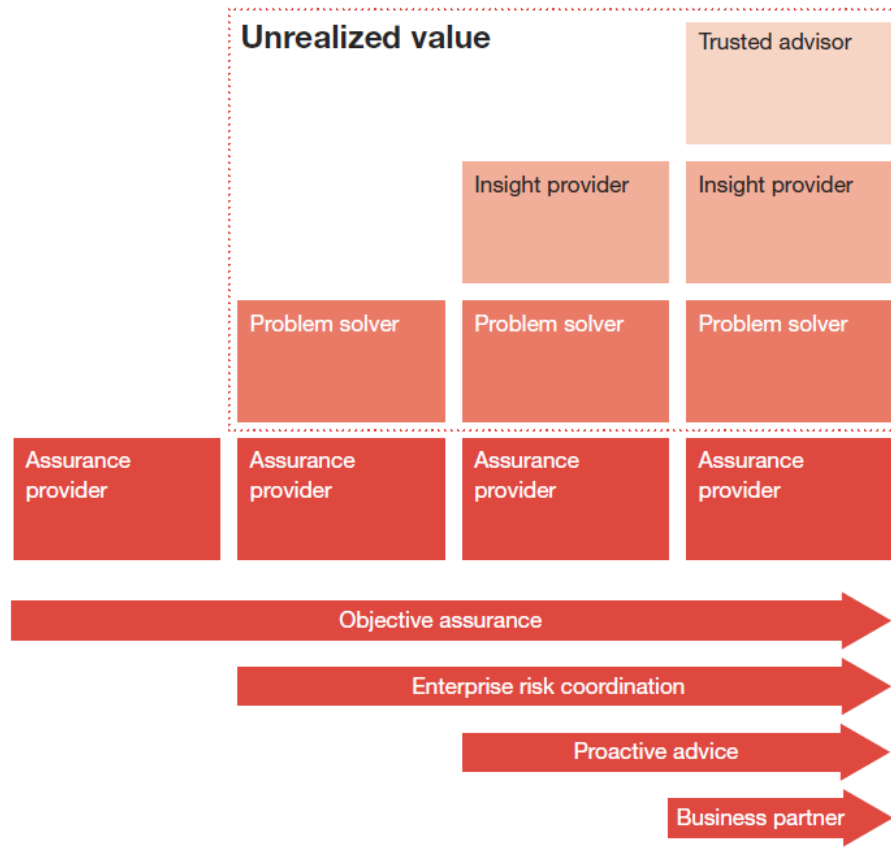
# *The path forward*

# The path to delivering more

To enhance its contribution – internal audit must first understand stakeholder expectations of internal audit’s role and assess what it must do to deliver

**What role do your stakeholders expect you to play?**

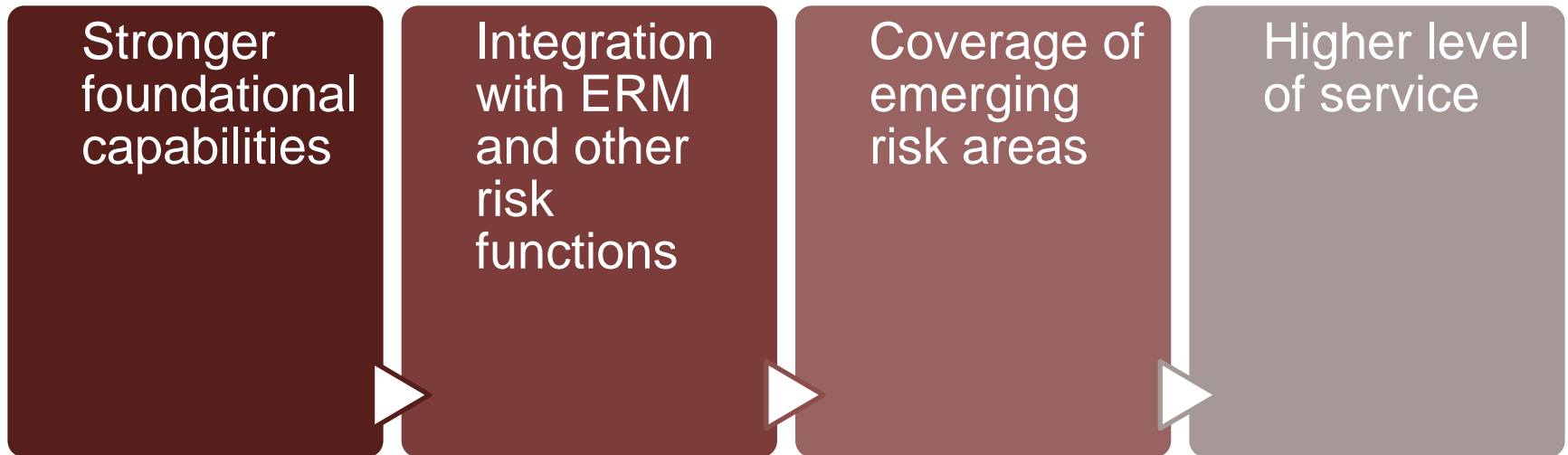
**What must you do to deliver? Consider value / contribution and performance capabilities.**



The survey data showed that when stakeholders indicated they viewed internal audit as providing significant value, there was a different level of service being provided.

## ***The path forward - defining greater heights***

***Our survey identified a subset of organizations represented by the top 5% of the respondent base as “high performing”***



***The high performing internal audit functions stood out from their peers in their contribution and value to the organization***

# *Successfully making the journey*

Each stakeholder plays a role in enhancing the value internal audit can deliver

## **Audit Committee**

**Ask  
more**

- Ask whether 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

## **Chief Audit Executive**

**Deliver  
more**

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

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# *Thank you*

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