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Adapt or disappear

To navigate inevitable upheaval,
internal audit must lead the way



In May 2015, Deloitte sponsored the Chief Audit Executive (CAE) Forum, a two-day event featuring keynote speakers, workshops, demonstrations and brainstorming. CAEs from selected client organisations were invited to participate in the event with the goal of gaining new perspectives, ideas and inspiration. This article offers some insights gleaned from the event.

“By this time next year, Airbnb will earn the title as the largest hotel chain in the world.”

So predicted Salim Ismail, founding executive director of Singularity University, at the CAE forum.

Who should care?

- The heirs of John Willard Marriott and Conrad Nicholson Hilton
- Every other businessperson in the world

Foundational change

Designation as the world’s top lodge may be of interest to the hotelier community but perhaps few others, except for one extraordinary fact: **Airbnb does not own a single hotel room.**

Instead, Airbnb shook the foundation of the hotel industry by leveraging technology to transform the business model from product-based to service-based. Today, when a traditional hotelier wants to add to its room inventory, it must build a new hotel. Conversely, Airbnb expands capacity at virtually no cost through its network of community hosts. Advantage: upstart.

What other industries have been similarly undercut and transformed, to the detriment of established players? An easier question might be, what industries have not? Media, entertainment, transportation, manufacturing, finance, retail, technology, education, and consumer products have all undergone upheaval—*the list goes on and on.*

As Ismail noted in this article, “Uber has very low marginal cost to add a new car to its fleet. Yelp reviewers actually build the product. Google’s marginal cost to running an extra search query is almost zero. Waze, the world’s largest community-based traffic and navigation app, has reached almost 100 million users solely by word of mouth and accesses each user’s GPS to provide accurate traffic prediction. When you become a Waze user, not only are you providing demand, you are the supply.”

What does this mean for your company? Three words:

Adapt or disappear.

Inevitable upheaval

Top executives—and those who advise them—must understand the inevitability of exponential change and the fact that their organisations will be significantly impacted. Technology is transforming the business landscape at a rapid—some say alarming—rate, as traditional business models are toppled one by one.

But the situation is neither dire nor hopeless for those with foresight, based on insight.

Adaptable organisations do not rest on their laurels. For example, after Netflix bankrupted its rival Blockbuster, it continued to evolve, adopting streaming video to supplement its DVD-by-postal-mail business model. After Apple transformed, first the music business (Tower Records—vanquished) and then the smartphone business (BlackBerry—diminished), it turned its sights to wearable computers (Apple Watch), and reportedly is eying other industries to conquer. (Executives in the *automobile*, *television*, and *healthcare* industries should be wary.)

How can other companies emulate these business pioneers, who not only respond to change but are catalysts for change? The answer may surprise you: Internal audit can lead the way.

Consider: No other group within the organisation has the skills, the tools, the personnel and the mandate to forge this path to the future. The C-suite? Often consumed by the present. The Board? Direct but cannot execute. Corporate counsel? Too narrowly focused. The Chief Risk Officer? Often more fixated on risk than opportunity.

This rapidly changing landscape presents an opportunity for organisations with bold, agile CAEs and their teams. To help the company adapt, internal audit must also change. Gone are the days when internal audit could exclusively rely on traditional methods of executing its mandate and to continue to hire from the same gene pool. Audit plans followed over the last five years will be of little use in the next five; a narrow focus on the past (financial reporting) and the present (cash flows, quarterly earnings and compliance) must yield to an expanded view of the future.

As noted in The Broken Triangle, Deloitte's whitepaper discussing the dynamics of internal audit, visionary chief audit executives will recast the job description of their internal audit groups to include roles such as:

- **Advisor** — advising management on risks related to strategic initiatives, industry, organisation, process and systemic changes (Insight).
- **Prognosticator** — peering ahead to help management envision and act on future risks and opportunities (Foresight).
- **Advocate** — identifying and helping to mitigate risks associated with protecting and increasing shareholder value (Oversight).

Navigating the future

The following steps will help internal audit navigate from the present to the future:

1. **Shape and align with stakeholder expectations:** The audit committee and management must fully understand and embrace the required evolution of internal audit. Full transparency, open communications and a persuasive advocate will assist in this process.
2. **The right skills and competencies:** Traditional assurance skills relating to controls and compliance must be augmented with specialised advisory skills that encompass strategy, strategic risk, scenario planning, as well as business and industry acumen. Teams are well-advised to consider adding specialists such as data analysts, engineers, supply chain professionals, and others.
3. **Consider alternative staffing models:** Internal audit must deliver the right skills in the right quantities in the right locations. To remain nimble and responsive, alternative delivery models such as co-sourcing and outsourcing as well as crowd sourcing and virtual teams should be considered. Crowd-sourcing becomes an interesting consideration.
4. **Rebalance the audit plan:** Ensure that a proper balance exists between assurance and advisory activities. Most internal audit groups will find that an increase in advisory activities will be needed to remain relevant in light of ever-changing and increasing stakeholder expectations. This will require assurance activities to come more technologically embedded, for example, through Continuous Controls Monitoring.
5. **Audit the strategic planning process:** Verify that management has a robust strategic planning process with appropriate scenario planning that identifies “*Value Killer*” risks and plans to address these risks.
6. **Drive the spirit and effectiveness of the Combined Assurance model:** In an optimal risk management structure, business unit owners constitute the first line of defence; the risk management function makes up the second line; and internal audit are part of the third line. Just as the second line evaluates the first, so too should the third line assess the second and first lines – in an end-to-end manner. In particular, the risk management function’s process for identifying and assessing emerging risks should be evaluated. Consider whether the organisation’s risk processes really think the unthinkable.
7. **Leverage technology:** Technology has transformed business and it has the potential to transform internal audit as well. Harness technology tools to improve insights and reduce costs. Integrate data analytics, risk sensing and visualisation tools to increase coverage and efficiencies as well as to provide deeper insights and actionable recommendations to stakeholders.
8. **Gain influence:** Strong leadership from the CAE, a compelling articulation and cultivation of an impactful role, including as a trusted advisor, will help raise the stature of internal audit and gain the CAE a seat at the table with other C-suite executives for greater influence and impact.
9. **Communicate effectively:** When communicating with stakeholders, static PowerPoint presentations should be shelved in favour of (or at least supplemented by) dynamic reporting available through analytics and visualisation tools. Graphic representations of emerging threats and opportunities can be a powerful means of informing and persuading.

Profound change

It's easy to get mired in the past and bogged down in the present, but the future beckons. How profound are the changes that lie ahead? Google's development of a self-driving car provides both an example and a metaphor.

Since Google cars first hit the road in 2009, the vehicles have logged more than 1.8 million miles and have been involved in 12 minor accidents, none with injuries and none, *according to Google*, the fault of the autonomous vehicle. Being rear-ended while stopped at a traffic light represents a typical accident scenario.

Meanwhile, as the safety benefits of the car become increasingly apparent, the technology costs continue to drop. The first generation Google car cost US\$300,000 to retrofit, said Ismail, the keynote speaker at our recent Chief Audit Executive Forum. The second, US\$75,000. And the most-recent prototype, US\$1,000.

This pattern of plummeting costs is a hallmark of transformative technology that has been observed in countless other enterprises, including computer chip production, solar panel manufacturing, 3D printer development, and human genome mapping.

In this light, the Google car can be seen as a harbinger of the exponential change that companies will need to address. "In two decades, we'll look back and wonder why we ever let human beings drive," said Ismail. The future may bear little resemblance to the past, and only the most forward-thinking companies will survive the transition—with the guidance and support of internal audit.

Is your internal audit function ready to meet the challenge that awaits?

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