Enhancing the strategic value of Internal Audit

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Executive summary

The Internal Audit (IA) activity in an organization is primarily dedicated to strategically assess and improve governance, risk management and internal control processes. In line with this, a majority of IA professionals and executive stakeholders agree that assessing risks and risk management practices are among the most important functions that Internal Audit teams across organizations can currently deliver, or have the potential to deliver.

The findings from our 2017 UAE Internal Audit survey suggest that Chief Financial Officers (CFOs), heads of Internal Audit and Audit Committee chairpersons generally agree that there is significant scope to have the IA play a more strategic role. This could be done by better positioning the IA activity so it delivers greater business value and improves in overall efficiency and effectiveness.

As companies attempt to redefine their IA activities, internal auditors are increasingly expected to view their activities from a business perspective. To be in a position to do so, a sustained flow of communication between the IA and the rest of the organization is essential. The IA activity could then be expected to play a more strategic role within the organization.

The 2017 UAE Internal Audit survey therefore attempted to address two critical questions:

- How to best define IA quality?
- What can organizations do to improve IA quality?

We found that for a majority of respondents, IA quality is synonymous with commitment to continuous improvement, while the provision of internal/external training would be the most suitable measure that could improve the quality of IA.

The future of the Internal Audit role also depends on its ability to embrace emerging technologies. The benefits of adopting emerging technologies within IA activities and the overall effect on efficiency was acknowledged by the majority of our survey respondents across the UAE.

In terms of internal audit sourcing, co-sourcing is one of the most popular avenues, whether globally or in the UAE. The future of the IA activity may therefore lie in the adoption of a co-sourcing approach, whereby most organizations believe that adopting this model enables organizations to benefit from wider business sector knowledge.

The survey also explores possible scenarios which, if implemented, could improve the efficiency of IA activities:

- An increased focus on strategic sourcing, especially co-sourcing
- Hiring Chief Audit Executives (CAEs) with the appropriate skill set and talent
- Adopting and aligning internal control and the IA activity with the COSO 2013 framework
- Leveraging optimal technological solutions and capabilities

As the need for risk oversight continues to be felt, a growing number of organizations are aware that the combination of the IA and risk management functions could enhance risk management capability. In fact, according to a majority of executive stakeholders and IA professionals, using risk management tools can add enormous value to the IA process, as they seek to achieve efficient risk mitigation.
As businesses become more complex and diversified, the expectations related to the Internal Audit (IA) activity also grow significantly, ranging from management-level activities to everyday tasks. The scope for IA responsibilities has expanded beyond traditional compliance and financial reporting, to now encompass: identifying emerging risks and facilitating the implementation of enterprise risk management (ERM).

As new laws and regulations are introduced, their requirements challenge boards to maintain higher levels of transparency, objectivity and professionalism. Some experts believe that internal audit is one of the key entities which enables the assessment of enterprise-wide risks. In the UAE, nearly two-thirds of the surveyed executive stakeholders and nearly 60 percent of IA professionals agreed on the inclusion of internal audit to provide an integrated view of the adequacy of enterprise-level risk coverage.

The IA department can play a critical role in an organization as it can provide knowledge pertaining to market intelligence, quality assurance, compliance adherence, intra-organizational data interdependencies, risk assessment and risk management.

Our survey shows that 9 in 10 IA professionals (87 percent) and executive stakeholders (88 percent) agree that the **assessment of risks and risk management practices** are the most important functions which are currently being delivered, or can be delivered by IA teams. In addition, more than eight out of 10 IA professionals believe that the ability to **generate informed perspectives on emerging risks** can also be delivered by IA teams.

Both UAE-based IA professionals and executive stakeholders agreed that organizations increasingly regard the identification of emerging risks and comprehension of organizational efficiency and effectiveness as two main characteristics which define the IA activity (Chart 1). This is in line with the findings derived from the similar global survey, which reported that IA professionals were more likely to describe an insightful and valuable IA in similar terms.

In essence, internal auditors may play a key role in an organization’s cost reduction and rationalization efforts; can offer performance-driven business solutions; and identify instances of fraud, inefficiencies and non-compliance. It is therefore imperative for organizations to ensure a consistently high level of IA quality.

This brings two important questions to the fore: how to supervise IA quality and what can organizations do to achieve it?

**Chart 1: Which of the following characteristics best describe an insightful and valuable Internal Audit?**

<table>
<thead>
<tr>
<th>Feature</th>
<th>IA Professionals</th>
<th>Executive Stakeholders</th>
</tr>
</thead>
<tbody>
<tr>
<td>Provides insight into efficiency and effectiveness</td>
<td>85%</td>
<td>76%</td>
</tr>
<tr>
<td>Reveals existing and emerging risks</td>
<td>75%</td>
<td>68%</td>
</tr>
<tr>
<td>Finds potential revenue enhancement, cost savings and/or smarter CAPEX</td>
<td>60%</td>
<td>51%</td>
</tr>
<tr>
<td>Increases communication across the organization</td>
<td>54%</td>
<td>25%</td>
</tr>
<tr>
<td>Provides operational feedback</td>
<td>47%</td>
<td>41%</td>
</tr>
<tr>
<td>Provides compliance feedback</td>
<td>47%</td>
<td>53%</td>
</tr>
<tr>
<td>Other (please specify)</td>
<td>4%</td>
<td>2%</td>
</tr>
</tbody>
</table>
Defining superior IA quality, and how to improve it

The majority of the IA professionals (75 percent) and executive stakeholders (63 percent) in the UAE define IA quality as a ‘commitment to continuous improvement’ - a response similar to the one provided by their global counterparts (79 percent).

Meanwhile, 9 in 10 IA professionals and 8 in 10 executive stakeholders agree that consistent and systematic career development training provided to IA professionals can improve the overall quality of IA within an organization. Internal and external training, along with cross-functional experience, are likely to enable auditors to further their knowledge of both audit systems and overall processes, and operations. This would subsequently allow them to better identify and map emerging risks and potential business opportunities against the organization’s strategic priorities.

Elevating the IA activity

Such methods can elevate the status of the IA role itself, a perception shared by more than 9 in 10 IA professionals (93 percent) and 8 in 10 executive stakeholders (80 percent) in the UAE.

Outsourcing was also identified as one of the means which could improve IA quality in an organization. There is however some divergence of opinion on the matter between executive stakeholders and IA professionals, with almost half of the former believing in using outsourced services to improve IA quality, versus 25 percent of IA professionals. While, there are a few limitations associated with this practice, such as a potential lack of in-depth understanding of business operations that are typically imbibed by in-house auditors, outsourcing was generally believed to have important advantages.

For instance, organizations may have recourse to outsourcing as part of their cost reduction and rationalization efforts. Outsourcing also grants an organization access to a certain level of expertise which may not be practical or cost-effective to maintain in-house. In addition, outsourcing (or co-sourcing) the audit activity can help minimize the actual or apparent loss of objectivity and may further lead to knowledge sharing between in-house auditors and the co-sourced party, resulting in a more effective and enhanced IA quality.

Chart 2: Top three ways to ensure IA quality – currently or in three years?

<table>
<thead>
<tr>
<th>IA professionals</th>
<th>Now</th>
<th>In 3 years</th>
</tr>
</thead>
<tbody>
<tr>
<td>Provide internal training/external training</td>
<td>69%</td>
<td>24%</td>
</tr>
<tr>
<td>Elevate the status of the audit function</td>
<td>69%</td>
<td>24%</td>
</tr>
<tr>
<td>Provide auditors with experience across functions (e.g. rotation)</td>
<td>46%</td>
<td>45%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Executive stakeholders</th>
<th>Now</th>
<th>In 3 years</th>
</tr>
</thead>
<tbody>
<tr>
<td>Provide internal training/external training</td>
<td>46%</td>
<td>36%</td>
</tr>
<tr>
<td>Elevate the status of the audit function</td>
<td>46%</td>
<td>34%</td>
</tr>
<tr>
<td>Offer attractive career tracks to attract</td>
<td>31%</td>
<td>47%</td>
</tr>
<tr>
<td>Provide auditors with experience across functions (e.g. rotation)</td>
<td>27%</td>
<td>51%</td>
</tr>
</tbody>
</table>
IA and strategy —
A vital connection

While the strategic role of IA appears to be more aspirational than actual, there is significant scope to better position the IA activity to deliver greater business value.

Chart 3: Is internal audit a strategic or support activity in your organization?

<table>
<thead>
<tr>
<th></th>
<th>Global results</th>
<th>UAE results</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>IA professionals</td>
<td>Executive stakeholders</td>
</tr>
<tr>
<td>Now</td>
<td>60%</td>
<td>99%</td>
</tr>
<tr>
<td>In 3 years</td>
<td>40%</td>
<td>1%</td>
</tr>
</tbody>
</table>

In today’s dynamic and complex business environment, organizations must focus on implementing continuous improvements to their current processes if they seek to be more efficient, achieve strong results and benefit from sound governance. Companies must aim to be in a better position to ascertain risks and opportunities that can improve their chances to succeed. The IA activity can contribute to identify these and subsequently provide insights on ways to ensure continuous improvement.

The IA activity therefore has the potential to offer value-added and beneficial services to an organization’s management and board, and should be recognized as an essential component of its overall strategy.

IA – strategic or support role?
Internal Audit can play both a strategic and a support role within an organization. However, given the potential insights and added value provided by IA, one could associate this role more with strategy than support, as highlighted by the participants in the global survey. According to 6 out of 10 IA professionals and almost all (99 percent) executive stakeholders surveyed globally, the IA activity is, by essence, more of a strategic one.

However, when considering the UAE stakeholders’ point of view, a regional-global divergence emerges. According to our 2017 UAE survey results, half of the IA professionals (52 percent) and two thirds of the executive stakeholders (63 percent) consider IA to be more of a support than strategic function.

This stark difference in the global and UAE results indicates that the strategic nature of IA is more aspirational than a reality in the UAE. Indeed, both IA professionals and executive stakeholders aspire to see the role of the internal auditor evolve into that of a more strategic partner in the near future.

In fact, according to the UAE survey, only 34 percent of auditors and 20 percent of the executive stakeholders believed that IA professionals were involved in an organization’s strategic planning process, as opposed to being involved in the elaboration of the strategic plan itself. (Chart 5).

While all professionals and leaders are aware of the strategic links between IA and the overall business strategy, only a fairly limited involvement of the IA activity remains, especially during the elaboration phase of a company’s business strategy. This may explain why nearly all IA professionals (93 percent) and most executive stakeholders (80 percent) are convinced that improving the status of the IA activity could contribute to an overall improvement in the quality of IA.

It is imperative to highlight here that, by definition, the role of IA is rarely to help set a strategy. Rather, it is to audit an organization’s processes and to subsequently facilitate deep-dive analysis of strategic decisions, evaluate possible risks, and thereby be in a better position to provide insights to the management.

It is therefore critical for the IA activity within an organization to be aligned with its strategic priorities and be involved in the overall strategic planning process, either through consultation and/or through review of outcomes.

For instance, while determining strategic initiatives, inputs from the IA team should be sought and taken into consideration.
The IA activity should, ideally, reflect a profound understanding of business processes and be in a position to identify potential issues that could disrupt these processes and devise ways to mitigate them.

In the UAE, with the support of the management, the IA activity should be increasingly involved in improving its knowledge of business matters and not only be limited to questions related to processes, controls and compliance. While assessing risks is important, the role of IA should also be about keeping an eye out for potential opportunities that the business is seeking or can capitalize on.

Organizations should therefore focus on enhancing the maturity of the IA activity. Internal auditors should increasingly be in a position to understand their contribution to the business — to deliver necessary insights to identify growth opportunities for the organization and share perspectives on potential risks to the business.

To achieve this, there needs to be a constant dialogue between the IA activity and the business. Once this is established, one can expect the IA role to improve its contribution to strategic decision-making.

**Chart 4: How would you like to see the role of IA as a profession to evolve?**

<table>
<thead>
<tr>
<th>Desired Evolution</th>
<th>IA professionals</th>
<th>Executive stakeholders</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increased visibility in the organization</td>
<td>52%</td>
<td>54%</td>
</tr>
<tr>
<td>Become a more strategic business partner</td>
<td>42%</td>
<td>49%</td>
</tr>
<tr>
<td>Be more proactive in the organization</td>
<td>35%</td>
<td>38%</td>
</tr>
<tr>
<td>Be more proactive about providing quality in audits</td>
<td>46%</td>
<td>46%</td>
</tr>
<tr>
<td>Be more proactive about providing more insights</td>
<td>48%</td>
<td>41%</td>
</tr>
<tr>
<td>Be more proactive about providing more value in audits</td>
<td>30%</td>
<td>36%</td>
</tr>
<tr>
<td>Should be able to match the complexity of the functions it audits</td>
<td>29%</td>
<td>31%</td>
</tr>
<tr>
<td>Become more proactive in dealing with its stakeholders</td>
<td>39%</td>
<td>39%</td>
</tr>
<tr>
<td>Become more diversified with skills</td>
<td>42%</td>
<td>22%</td>
</tr>
<tr>
<td>Become more diversified with activities</td>
<td>36%</td>
<td>24%</td>
</tr>
<tr>
<td>Become more proactive in dealing with its stakeholders</td>
<td>31%</td>
<td>24%</td>
</tr>
<tr>
<td>I think Internal Audit is at the evolved state to which it should be</td>
<td>29%</td>
<td>7%</td>
</tr>
</tbody>
</table>

**Chart 5: How is IA aligned with your organization’s strategic initiatives?**

<table>
<thead>
<tr>
<th>Strategic Alignment</th>
<th>IA professionals</th>
<th>Executive stakeholders</th>
</tr>
</thead>
<tbody>
<tr>
<td>Internal Audit leadership is involved in the Strategic Planning process</td>
<td>48%</td>
<td>30%</td>
</tr>
<tr>
<td>Internal Audit is informed of the results of the Strategic Planning process</td>
<td>46%</td>
<td>20%</td>
</tr>
<tr>
<td>Internal Audit does not have a role in Strategic Planning</td>
<td>34%</td>
<td>24%</td>
</tr>
</tbody>
</table>
In an age heavily influenced by digital transformation, organizations are often being reminded of digitization and its benefits in improving efficiency. Companies globally now seem keen to explore the advantages of using emerging technologies. This approach has percolated to most functions of an organization, including IA.

In the UAE, a majority of executive stakeholders (80 percent) and IA professionals (76 percent) surveyed believed the adoption of technology can trigger greater efficiency – a perception shared by their global IA professional counterparts (75 percent).

From audit management software and cloud computing to mobile apps and big data, internal auditors appear keen to explore how emerging technologies can change the way they work, help them become more productive and deliver greater value to the business.

As per the 2017 UAE survey, only a third of executive stakeholders and IA professionals opted to enhance their technological capabilities for certain functions/risks on a regular basis.

Importance of data and analytics
To achieve this objective, many auditors are increasingly adopting data and analytics. In the UAE, nearly 5 out of 10 respondents across both groups (executive stakeholders and IA professionals) stated they had already started implementing analytics within their respective organizations.

Nonetheless, our survey also shows that a greater proportion of executive stakeholders believed that internal audit activities within their organizations had not yet implemented Data & Analytics within their organizations. This is primarily due to the underlying complexity of implementing analytics in IA.

In the UAE, a majority of executive stakeholders (80 percent) and IA professionals (76 percent) surveyed believed the adoption of technology can trigger greater efficiency – a perception shared by their global IA professional counterparts (75 percent).

From audit management software and cloud computing to mobile apps and big data, internal auditors appear keen to explore how emerging technologies can change the way they work, help them become more productive and deliver greater value to the business.
Challenge the status quo
As part of an ever-changing business environment, organizations today are aware that maintaining the status quo is not a satisfactory option. It is therefore important for companies to be agile enough to cope with unexpected events and challenges.

For this purpose, adopting a technology-enabled two-phased approach of continuous auditing and monitoring is vital. Together, these methods can enhance the timely, ongoing review of financial data and internal control within an organization.

While continuous auditing can assist auditors as they analyze data for early identification of outliers or risks, continuous monitoring further enables the management team to assess the business against key performance metrics.

Emerging technologies
The fourth industrial revolution has paved the way for emerging technologies such as Robotic Process Automation (RPA) and Artificial Intelligence (AI), which can offer auditors the opportunity to be innovative in various aspects of IA, such as risk assessment, planning, execution and reporting.

Some audit activities have already started considering using bots for routine control testing. These can perform tasks in a fraction of the time and for a fraction of the cost required of a real person. While some in the consulting world speculate on the impact of robotics on headcount and costs, auditors are increasingly exploring this option as a means to alleviate perennial constraints of resources and budget.

Furthermore, in the case of AI, the technology offers non-negligible advantages, such as reduction in errors, higher efficiency and ability to make better predictions. Another area wherein auditors can leverage the benefits of AI is during the document review process — machine learning now makes it possible to train the system on a set of sample contracts until it ‘learns’ how to identify and extract key terms. This in turn can potentially provide auditors with more time to focus on examining more complex and higher risk areas.

Another such example is the combination of cognitive technology with visualization tools. This can bring audit information to life through automated charting and graphics, thus allowing a detailed analysis of data and timely and calibrated responses.

The future of IA therefore rests on the ability of the activity to widen its scope in a manner that would enable it to not only focus on the traditional regulatory and compliance matters but also help organizations manage risk and operations.

As demonstrated in this survey, the IA activity has been slow, and at times reluctant, to leverage data & analytics. It is critical that the IA activity looks to embrace the digital revolution and use technology to its advantage.

Chart 8: What advanced data analysis tools does your company use?

- We have purchased and use a Data & Analytics tool (e.g., ACL, SQL, Alteryx, SAS, IDEA)
- We primarily rely on standard Microsoft tools (e.g., Excel, Access)
- Not Applicable

Enhancing the strategic value of Internal Audit
The significance of IA sourcing models

Global level executive stakeholders and UAE-based experts have diverging views on the responsibilities of internal audit activity within an organization.

In recent years, the internal audit activity has gained in importance and now assumes a more varied set of responsibilities. As business structures become more complex and operations more sophisticated, there is a pressing need to ensure that risks are adequately managed.

A company’s overall goals should be compliant with audit policies and procedures. Yet, both UAE-based executive stakeholders and IA professionals recommend that internal audit should play a better role when it comes to recommending policies and procedures. They also go on to suggest that organizations rely less on third-party providers and other in-house departments.

The role of internal audit across business functions is expanding. Globally, around 85 percent of executive stakeholders believe that internal audit should be considered for its capacity to leverage financial reporting certifications and provide external audit assistance.

UAE-based executive stakeholders and IA professionals, however, would instead prefer the involvement of a third-party. Almost half of both the executive stakeholders (47 percent) and IA professionals (46 percent) believe that a third-party should be leveraged to validate financial reporting certifications and provide external audit assistance.

One of the most critical aspects of the internal audit activity is risk assessment. A high proportion of UAE-based executive stakeholders (56 percent) and an even more IA professionals (70 percent) would rather rely on internal audit to provide insights into strategic, operational, legal and regulatory and financial risk coverage. They would prefer internal audit to operate in a management advisory capacity, and be involved in the design of risk-associated processes and controls.

At a global level, executive stakeholders perceive that either internal audit or a third party can provide independent assurance regarding the adequacy of financial risk. However, more than half of UAE-based executive professionals (59 percent) and IA professionals (62 percent) prefer only internal audit for independent assurance regarding the adequacy of financial risk.

Chart 9: Top three key areas where internal audit can play an important role according to UAE-based executive stakeholders and IA professionals

<table>
<thead>
<tr>
<th>Area</th>
<th>Executive Stakeholders</th>
<th>IA Professionals</th>
</tr>
</thead>
<tbody>
<tr>
<td>Management advisory in designing processes for various risks</td>
<td>61%</td>
<td>84%</td>
</tr>
<tr>
<td>Provide insights into various types of risk coverage</td>
<td>59%</td>
<td>71%</td>
</tr>
<tr>
<td>Audit company policy and procedure</td>
<td>68%</td>
<td>90%</td>
</tr>
</tbody>
</table>

Executive Stakeholders
IA Professionals
In-sourcing: Still a preferred option?

UAE-based executive stakeholders and IA professionals differ from their global counterparts when it comes to internal sourcing of internal audit activities.

Achieving leading internal audit capabilities requires significant investment in skilled resources, methods, training, career paths and technical infrastructure. While organizations of all sizes can benefit from internal audit, the decision of choosing an in-house team of internal audit staff, outsourced or co-sourced can have an impact on the value generated by internal audit.

Choosing the right internal audit model begins with an accurate assessment of the complexity and needs of the organization in question. Every model has its own set of benefits and drawbacks.

Companies that have in-house internal audit functions enable the management to gain instantaneous knowledge of any issue at hand, which in turn allows them to retain full control over their approach. A key advantage of this model is that it provides a suitable arena for developing future leaders within a particular organization. Members of the internal audit department are trained on various functions within the organization itself, which enables them to develop an adequate understanding of the key risks and challenges faced by the organization in question.

One of the drawbacks of the internal sourcing model is the difficulty some internal auditors face when acquiring or maintaining the level of specialized skills. This is associated with the elevated cost associated with investing in the skill set required.

However, the last years have witnessed a decline in the popularity of this model. At a global level, only 4 percent of executive stakeholders preferred this approach and the number is expected to further decline.

Meanwhile, almost a third of UAE-based executive stakeholders stated their preference for the internal sourcing model. A similar trend was observed among IA professionals.

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**Chart 10: Percentage of UAE-based executive stakeholders and IA professionals preferring In-sourcing model**

Now

<table>
<thead>
<tr>
<th></th>
<th>Executive stakeholders</th>
<th>IA professionals</th>
</tr>
</thead>
<tbody>
<tr>
<td>32%</td>
<td>46%</td>
<td>27%</td>
</tr>
</tbody>
</table>

In next 3 years

<table>
<thead>
<tr>
<th></th>
<th>Executive stakeholders</th>
<th>IA professionals</th>
</tr>
</thead>
<tbody>
<tr>
<td>46%</td>
<td>46%</td>
<td>46%</td>
</tr>
</tbody>
</table>
Co-sourcing: Most popular avenue of internal audit sourcing

The future of the internal audit activity lies in the co-sourcing approach, globally or across the UAE.

Most internal audit activities now use some level of partial sourcing (also referred to as co-sourcing) arrangement to meet specific skill gaps or to benefit from wider industry sector knowledge.

By co-sourcing critical elements of an internal audit activity, an organization can look to instead reassign staff to tasks which focus on their core competencies, while benefiting from specific skill sets, best practices, industry and corporate audit knowledge. One of the main deficiencies of the internal audit co-sourcing model is that it requires continuous coordination from the organization to ensure seamless delivery of internal audit services.

The co-sourcing model is the most popular of the three sourcing models. Globally, 87 percent of executive stakeholders expressed a preference for this approach, with the number expected to rise to 90 percent in the next three years.

In the UAE, both executive stakeholders and IA professionals favor adoption of the co-sourcing model. However, it was observed that both groups slightly differed in opinion on when to implement it. Four out of 10 executive stakeholders (42 percent) are ready to adopt the co-sourcing model right away; more than 50 percent of both executive stakeholders and IA professionals are willing to implement it in three years’ time. Meanwhile, the enthusiasm for the two other models, namely insourcing and outsourcing, is expected to decline in the future.

IA professionals in the UAE have also acknowledged the benefits of co-sourcing with more than half convinced that co-sourcing is the best approach. It is expected to remain the most popular approach among IA professionals in the coming years.

With the growing popularity of co-sourcing, it is critical to identify the key traits organizations look for when deciding to adopt in-sourcing or outsourcing. A majority of global executive stakeholders (58 percent) feel that associating with external partners helps turn a fixed cost into a variable one, which offers them accessibility to subject matter experts.

Almost three out of four UAE-based executive stakeholders highlighted the significance of an independent perspective, especially when some internal stakeholders run the risk of becoming complacent or resistant to change. External partners can bring insights, information and best practices from their broader exposure. They are then better positioned to have more independent and clearer conversations with the upper management.

Looking at the perspective of UAE-based IA professionals, 56 percent of respondents gave greater priority to access to subject matter professionals. The involvement of industry experts reinforces their confidence in the level of assurance needed to grow sustainably while exploring the opportunities presented by an expanding risk landscape.

Chart 12: Preference for cosourcing

<table>
<thead>
<tr>
<th></th>
<th>Independent perspective</th>
<th>Ability to benchmark</th>
<th>Access to Subject Matter Professionals</th>
</tr>
</thead>
<tbody>
<tr>
<td>Executive stakeholders</td>
<td>76%</td>
<td>54%</td>
<td>51%</td>
</tr>
<tr>
<td>IA professionals</td>
<td>36%</td>
<td>45%</td>
<td>56%</td>
</tr>
</tbody>
</table>

Enhancing the strategic value of Internal Audit 15
Out-sourcing losing out to co-sourcing

There is a growing resistance among organizations to fully outsource their internal audit activities.

Apart from reducing operating expenditure, some companies believe that outsourcing the internal audit expertise to better-equipped specialists may lead to improved services and a more substantial return on investment. However, as per the current scenario, this model has some perceived drawbacks. The main one is that since expertise does not reside in-house, there is an evident limitation on the ability to transfer knowledge and build capabilities of the internal audit activity within the organization.

At both global and UAE levels, this model is the least preferred among the three and has also registered a consistent decline. That being said, one in four of the surveyed UAE executive stakeholders still prefer fully outsourcing the internal audit activity.

Given the current economic environment and potential, emerging risks, it is imperative to understand the concerns of an organization while opting to either co-source or completely outsource the internal audit activity.

A majority of executive stakeholders in the UAE (75 percent) believe that the lack of institutional knowledge is the biggest risk factor—a perception shared by most IA professionals.

When considering which sourcing option to adopt, organizations must consider which model is most suitable to their requirements. Companies must understand that the internal audit activity is increasingly playing an advisory role to the business. It is therefore essential to conduct a proper assessment of the various sourcing models and evaluate their respective suitability.
Enhancing the strategic value of Internal Audit
An effective IA department

A more regulated business environment means it is critical for organizations to have an effective IA department. This can be achieved by embracing strategic sourcing, adopting updated frameworks and leveraging technological capabilities.

The top-4 qualities of CAEs preferred by executive stakeholders and IA professionals are their:
(I) Attention to risk
(II) Communication skills
(III) Ability to be effective strategic business partners
(IV) Leadership capabilities.

Over the years, Internal Audit has become highly sophisticated and is virtually a business in itself. Hence, putting an effective IA department in place requires a significant level of investment in skilled resources, methods, training and technical infrastructure.

Attributes of an effective internal auditor

Critical thinking and good communication are essential skills that bring together all other components of an audit practitioner’s competency set. The essential set of skills required to be a successful internal auditor is also experiencing a massive shift. While technical skills remain absolutely necessary, internal auditors increasingly need to possess a broad range of non-technical attributes if they want to succeed.

Globally, executive stakeholders considered non-technical attributes as competitive differentiators. Two-thirds of the respondents perceive communication skills as the most which internal auditors ought to possess. Similarly, 62 percent of IA professionals reiterated the importance of soft skills.

At the UAE level, both executive stakeholders and IA professionals regard communication skills highly.

Another important trait appreciated by IA professionals around the world is ‘business acumen (critical thinking)’. At the UAE level, this is also considered as the most important skill set, according to the majority of executive stakeholders and IA professionals.

At the same time, in-house professionals are expected to develop their technical expertise by seeking out new assignments, projects and development opportunities.

Adoption of COSO 2013 and heightened focus on technology

The Committee of Sponsoring Organizations of the Treadway Commission (COSO) released its updated Internal Control – Integrated Framework in May 2013. This framework essentially provides audit committees and management teams with the opportunity to start afresh and view IA differently.

COSO 2013 helps create an effective control environment and a strong risk assessment process, including identifying and addressing fraud risks.

In the UAE, however, the level of adoption and alignment with COSO 2013 is still low. Among our survey respondents, a quarter (25 percent) of IA professionals claimed that their organization was aligned with COSO 2013, while only 8 percent of executive stakeholders agreed.

COSO 2013 and its updated framework focus on technology. The framework update, driven by changes in business and operating environments, encourages the use of, and reliance on, evolving technologies. It provides more guidance on how technology relates to an entity’s internal control structure.
In line with this (see chart 17), 9 out of 10 executive stakeholders (92 percent) and 8 out of 10 IA professionals (84 percent) told us of their intention to adopt and employ technology to help them identify and respond to emerging risks, in the next three years.

An effective IA department should aim to leverage the adequate technology solutions and use them as enablers for greater transparency and accountability for internal control and various internal audit activities. The new 2013 COSO framework also provides a new opportunity for internal audit committees to take a fresh look at internal control, create value for the organization and manage elevated expectations regarding internal control.

Hence, to gain from the prospective benefits and rewards, the IA department of tomorrow should:

- Focus on strategic sourcing, with a key focus on co-sourcing
- Employ CAEs with appropriate skills and talent
- Adopt and align the internal control and IA activity with the COSO 2013 framework
- Leverage the optimal technological solutions and capabilities

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**Chart 17: Organizations’ adoption of technological capabilities to identify and respond to emerging risks in 3 years**

- **We employ such capabilities enterprise-wide and rely on them**
- **We employ such capabilities regularly for certain functions/certain risks**
- **We employ such capabilities sporadically/adhoc**
- **We do not employ any technological capabilities to identify/respond to emerging risks**
- **Did not answer**
Risk management and IA: Creating synergies

The evolution of advanced risk management capabilities depends on an organization’s ability to create collaborative opportunities for both risk management and IA activities.

As the need for risk oversight continues to grow, companies increasingly acknowledge that a combination of IA and risk management can be extremely effective.

**Managing risk effectively**

In the UAE, at least two-thirds of both executive stakeholders (71 percent) and IA professionals (68 percent) agreed that the use of risk management tools add ‘enormous value’ to the internal audit process, which in turn results in efficient risk mitigation – a sentiment shared by two-thirds of the global executive stakeholders (67 percent).

An efficient risk management framework is one which is able to effectively maximize resources and minimize an organization’s susceptibility toward risks, be it internal or external. This may help successful companies in their efforts to stay relevant and evolve. However, given the dynamic nature of business, there are several perspectives on the importance of specific types of risk and what a company should focus on:

- For instance, while some people view emerging risks to be important, it has been observed that a sense of naivety is still prevalent among some members of senior management, especially when they assume that risks, such as cyber-attacks, may not affect their organization.

- Similarly, internal auditors are also said to be focusing more on operational risks as opposed to finance and compliance risks. Audit committees are now becoming increasingly dependent on IA to assist them as they navigate through a more complex risk landscape. This in turn may affect the day-to-day operations of a business.

- Due to the volatile nature of the business environment, risks may lead to strategic disruption and may significantly affect an organization’s foundation.

It comes as no surprise that both executive stakeholders and IA professionals in the UAE are well aware of the importance of an effective mitigation framework, and have expressed confidence in their organization’s ability to identify and adequately manage different types of risks: emerging, strategic, operational or compliance-related.

**Chart 18: How does your organization attain Enterprise Wide Risk coverage and mitigation?**

<table>
<thead>
<tr>
<th></th>
<th>Executive stakeholders</th>
<th>IA professionals</th>
</tr>
</thead>
<tbody>
<tr>
<td>Through a separate ERM function</td>
<td>20%</td>
<td>31%</td>
</tr>
<tr>
<td>Through a collaboration of several key functions (e.g. internal audit, legal, compliance)</td>
<td>25%</td>
<td>20%</td>
</tr>
<tr>
<td>Through the Internal Audit activity</td>
<td>34%</td>
<td>22%</td>
</tr>
</tbody>
</table>

**Chart 19: Strategic risk**

<table>
<thead>
<tr>
<th></th>
<th>Our company adequately detects and responds to Strategic risk</th>
<th>Our company adequately manage strategic risk</th>
</tr>
</thead>
<tbody>
<tr>
<td>Executive stakeholders</td>
<td>58%</td>
<td>63%</td>
</tr>
<tr>
<td>IA professionals</td>
<td>59%</td>
<td>64%</td>
</tr>
</tbody>
</table>
The need to collaborate
Given the overlap in roles, it is sometimes easy to get confused between risk management and IA, especially when answering key questions such as:

- How should a company view enterprise risk management (ERM)?
- How do risk management and IA fit in the larger scheme of things to facilitate enterprise-wide risk coverage?
- How can internal audit both assist and independently evaluate risk management activities?

This confusion in roles across some organizations may have hindered collaboration between these two functions, resulting in a less coordinated approach when it comes to dealing with risk.

Value creation for an organization
In light of the above, companies now increasingly require risk practitioners and internal auditors to work together, to add to the overall value they bring to an organization. Some key enablers that can help drive this process include:

- Linking an audit plan with enterprise risk assessment — Helps in efficiently identifying critical risks, creates an aligned view of the organization’s risk profile and adopts a consistent risk management vocabulary
- Sharing of talent and resources — Enables pooling of skills and expertise from both functions, which in effect would aid in developing a common understanding of risk management and consequently facilitate the achievement of an organization’s objectives
- Developing a common platform to ensure smooth cross-collaboration — Creates an ecosystem that supports increased inter-function communication between risk and IA

Chart 20: Operational risk

<table>
<thead>
<tr>
<th>Our company adequately detects and responds to Strategic risk</th>
<th>Our company adequately manage strategic risk</th>
</tr>
</thead>
<tbody>
<tr>
<td>Executive stakeholders</td>
<td>IA professionals</td>
</tr>
<tr>
<td>68%</td>
<td>69%</td>
</tr>
<tr>
<td>68%</td>
<td>68%</td>
</tr>
</tbody>
</table>

Chart 21: Compliance risk

<table>
<thead>
<tr>
<th>Our company adequately detects and responds to Strategic risk</th>
<th>Our company adequately manage strategic risk</th>
</tr>
</thead>
<tbody>
<tr>
<td>Executive stakeholders</td>
<td>IA professionals</td>
</tr>
<tr>
<td>71%</td>
<td>66%</td>
</tr>
<tr>
<td>71%</td>
<td>63%</td>
</tr>
</tbody>
</table>
Conclusions

Assessment of IA through a strategic lens
In any organization, the IA activity plays both a strategic and a supporting role. It therefore has the potential to simultaneously offer the most value to an organization’s management and board, making it an essential component of its overall strategy.

However, in the UAE, viewing IA as a strategic role is still limited to being more aspirational than real – a clear indication that while IA professionals and executive stakeholders are aware of the strategic link between IA and business strategy, there is ample scope to do more.

Collaboration is key
Internal audit and risk management are considered to be two sides of the same coin. Both functions are deeply invested in guarding an organization from potential threats and ensuring it maximizes its growth potential at every stage. Due recognition must therefore be given to companies which look into creating a collaborative environment for both functions to work together.

Technology-enabled continuous monitoring
With the growing potential offered by emerging technologies, such as artificial intelligence (AI) and robotics, the impact of technology on businesses is undeniable. This presents the IA activity with the opportunity to achieve greater efficiency. By leveraging the latest technological tools, continuous monitoring and auditing is possible. Not only can this help companies measure their real-time performance, it can also enable them to keep up with a dynamic risk landscape. Thus, it is important for companies to adopt and continuously invest in improving their technological capabilities, so as to reap the benefits of emerging technologies.

In-sourcing vs. co-sourcing vs. outsourcing
Choosing an appropriate IA model begins with an accurate assessment of size, complexity and needs of a particular organization. Consequently, the ‘one size fits all’ model does not apply when an organization is considering either of the three options: in-sourcing, co-sourcing or outsourcing. Given the dynamic nature of the business environment, this choice can be even more challenging as organizations strive to achieve their business goals efficiently and effectively.

The ideal IA department
Considering the various functions that IA performs for an organization, there are several schools of thought when it comes to providing a quintessential definition of ‘ideal’. That being said, a balanced mix of strong IA leadership, skilled resources, adoption of industry-standard frameworks and increased use of enablement tools offered by emerging technologies, are some of the elements that can help strengthen the IA capabilities in an organization.

Methodology

The survey was conducted by KPMG Lower Gulf in collaboration with the UAE Internal Auditors Association (UAE IAA). It is based upon responses from 150 respondents, 59 of which were executive stakeholders and 91 of which were Internal Audit professionals. The executive stakeholders comprised of Chief Executive Officers, Chief Financial Officers, Managing Directors, Heads of Risk, and Audit Committee Members. Out of 91 Internal Audit Professionals 76 were heads of Internal Audit.

Fifty-four percent were based in Dubai, 39 percent in Abu Dhabi and seven percent in the other five Emirates.

In terms of company annual revenue, 73 percent of the executive stakeholders worked at companies with annual revenue between US$10 million and US$5 billion, while 62 percent of the IA professionals worked at companies with annual revenue of between US$100 million and US$5 billion.

Some sections of this report also refer to the global internal audit survey. This survey was conducted by KPMG International among 134 members of the Institute of Internal Auditors (in July 2016), and 405 executive stakeholders (in July 2015).