



By mastering new ways of thinking, auditors can provide the business insights their stakeholders demand.

*Embedding*  
**Innovative  
Thinking**  
*Into Internal Audit's DNA*

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**R**apid technological advances have transformed the business world and pushed once stable economies and stalwart companies to the brink of collapse. To stay relevant, internal audit departments must embrace bold innovations. Improving risk assessments through altering frequency, depth, or breadth is insufficient. Evolving internal audit to include continuous monitoring, thematic auditing, and nontraditional staffing stops short of the transformative innovation desired by business. New business insight is the goal.

**THE CURRENT ENVIRONMENT**

Companies are more integrated, more interdependent, and more geographically dispersed than ever, while internal audit is tasked with doing more with less. Both of these factors create significant challenges for traditional internal audit operating models. PricewaterhouseCoopers' 2014 State of the Internal Audit Profession study cites quality and innovation as foundational attributes for adding significant

value and moving toward a trusted adviser relationship.

Meeting management expectations in a dynamic environment will require a new approach. Internal audit departments cannot afford to spend months designing a comprehensive risk universe that will become outdated immediately, nor can they devote resources to conducting extensive external research to assign risk ratings that will have short shelf lives. The need to respond to the latest headlines, attacks, and case studies necessitates a more nimble approach that permeates everything from planning to execution to reporting. Gone are the days when internal audit could spend one or two months on risk assessments, three or four months on audits, and one month on reporting. Acquiring additional resources to address a new issue that arises in the audit year also is unlikely. That begs the question: How does internal audit aggregate and synthesize organizational knowledge when this information resides within myriad people, systems, and resources, without increasing resources?

Fortunately, today's technologies give internal audit the ability to mirror the many-to-many relationships that define current business models. Mobile technology makes it easier to access data in real time. Visualization tools provide opportunities to demonstrate relationships in new ways and spark new conversations. Knowledge management tools can spotlight complex data relationships and root causes.

Like human beings, organizations suffer from multifactor illnesses. Fixing only one factor may provide modest, but temporary, gains that don't cure the illness. A more holistic approach is necessary to prevent recurrence and to achieve sustainable improvements.

Internal auditors need to connect disaggregated points of information, take a multifactor approach to problem-solving, and operate

nimbly within their current resource constraints. This begins with focusing inward to embed innovation within the department's operating model. The "Nationwide Case Study" on page 49 illustrates the impact inward innovation can have on internal audit.

### BENEFITS OF INNOVATION

Internal audit departments that embed innovation don't just realize process efficiencies, they also develop deep insights that position them as subject-matter experts. They begin to observe business operations differently and ask different types of probing questions that challenge their value. Reports change to focus on both the "message" and the big-picture story that provides context and creates a desire for change. Executives begin to request internal audit involvement. Operational practices are changed to accommodate management requests while meeting the audit

that internal audit departments should strive to achieve.

### CREATING A FRAMEWORK

Formal standards for innovation do not exist. However, a common definition has emerged within the educational arena. Generally, innovation is considered to have occurred when people create value by implementing new ideas. This definition establishes a basic framework that recognizes that innovation is done only by people, and generally, only by groups working collaboratively. The framework looks at knowledge-sharing systems, collaborative learning, and project and change management. Innovation experts generally concur that innovation occurs across a change spectrum.

An example of this change spectrum is a three-level model: improve, evolve, and transform. Level 1 innovation includes improvements that lead

**Innovation is done only by groups working collaboratively.**

committee's mandates. The relationship between business management and internal audit improves as internal audit earns a seat at the table.

The end result is that internal audit receives more valuable information that poises it to deliver better insights. Coincidentally, because of the deeper level of knowledge and greater data access created by innovation, internal audit is better positioned to objectively evaluate and improve risk management, governance, and control processes. Internal audit's monitoring role is enhanced. However, arriving at this point is not easy. While there is no one-size-fits-all approach, there are some common attributes within an innovative framework

to cost reductions and process efficiencies. Operational reviews, project assessments, and special projects focus on Level 1 insights. Level 2 innovation evolves existing products, services, or processes and identifies new uses, markets, or customers. This level of innovation requires asking different types of questions that focus on the other needs that could be served with the existing assets. Internal audit may question how to broaden the use of electronic workpapers, scheduling systems, knowledge management systems, or data analytic tools to meet stakeholder needs.

When internal audit gets to Level 3 innovation, transformation occurs.

Innovative organizations embrace **7 core values**: quality, individuality, trust, creativity, leadership, accountability, and measurement, writes Post University professor Don Mroz in *Wired* magazine.

New products and new business models emerge. Industry game changers arise. Level 1 and Level 2 innovations are more insular; the competitive impact is more limited. Level 3 innovation is disruptive—the competitive landscape changes. Because of the high-risk, high-reward nature, Level 3 innovation more often occurs within venture and startup companies. For example, large-scale outsourcing of finance and risk functions to third-party providers

challenged industry models starting in the 1990s. More recently, Netflix has transformed the movie rental business model, creating a new video-streaming market. Internal audit departments that engage in transformative innovation or spot opportunities within external innovations serve their companies well.

#### DRIVING INNOVATION

Embedding innovation into internal audit's DNA requires a focus on three

## NATIONWIDE CASE STUDY

**N**ationwide Mutual Insurance Co. is a U.S.-based Fortune 100 insurance and financial services company. Its internal audit department's data analytics program began as a way to decrease audit time while increasing audit coverage, say CAE Kai Monahan and Chris Tennant, associate vice president of internal audit. The program evolved to provide risk- and control-related business insights. Transformation began when the program was enhanced to include data analysis and visualization tools. Internal audit uses these tools to highlight previously unidentified trends in complex areas such as underwriting. The tools point out complex relationships and potential anomalies by compiling and analyzing data from a variety of sources.

Auditors at Nationwide also have used data analytics and visualization tools to analyze information from different sources used within real-time compliance processes such as anti-money laundering. As a result, internal audit improved the compliance department's ability to maintain reliance over critical processes. The internal audit team continues to work with peers in the organization to identify opportunities to use data analytics in their own areas. Monahan and Tennant say they expect internal audit's user-advisory role will continue to grow as more business areas experience the value delivered.

Monahan and Tennant advise internal audit departments that want to innovate with analytics to:

- » **Outline Strategy.** Is the purpose to support audits, move toward continuous auditing, spur process innovation, or something else?
- » **Determine Needs.** Consider which resources internal audit will need to accomplish its strategy. This consideration goes beyond tools to include data and skill sets. Internal audit will need strong technical knowledge, curiosity, and non-tool-specific analytical skills.
- » **Start Small.** Start with more traditional areas that aren't overly complex to figure out the process, build up knowledge, get quick wins, and gain buy-in within the internal audit department and with business partners. As internal audit's efforts mature, it can expand into more complex areas.



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to see a video  
interview with  
author Tiffany  
Crosby.

pillars: skills, culture, and infrastructure. Auditors must be able to think critically, solve problems, and constantly want to learn more (see “The Competency Wheel” on this page). Individuals should study their environment, observe what works well and what causes frustrations or problems, and use associative thinking to discover relationships among abstract or disconnected knowledge points. They should study a broad range of topics to increase their knowledge, be alert to hurdles to innovation, and make time to analyze problems more deeply. They also should possess strong business acumen and communication skills, as well as understand industry tools, methods, and practices.

**Skills** Internal audit should have a structured learning program in place that includes formal, informal, and social learning. The development process should use workshops, conferences, classroom-based and online training, personal reading, and networking. The time expected to be allotted to learning should exceed the traditional 40 hours a year. Developing an innovative mind-set requires a personal investment of time, high energy and drive, and a long-term commitment. Internal audit should be the best read, best connected, and best informed group within the organization. Auditors should be textbook examples of using social media to parse and push information.

**Culture** The culture must support innovation by providing an environment where failure is accepted and innovation is cultivated intentionally by rewarding sensible risk-taking, trial-and-error experimentation, and flexible and adaptable management philosophies. The culture must be characterized by empowerment, trust, openness, and formal and informal

continuous learning. Participation in internal and external networking forums within and outside of one’s group should be expected.

The 3M Corp. encourages its scientists to go into the field to observe customers to understand their pain points. Customers also visit innovation centers set up specifically for the purpose of exploring possibilities, solving problems, and generating product ideas. The appetite for finance and accounting involvement in innovation continues to increase. Building relationships in the field and using social media to increase internal and external knowledge-sharing capabilities are easy first steps.

**Infrastructure** The infrastructure must support innovation by incorporating effective project management, change management, budgeting, and scheduling processes; providing tools that harness knowledge and facilitate learning and collaboration; and redefining metrics that measure success. Budgeting and scheduling unstructured time places a value on the innovation process. Intuit, Google, Atlassian, and 3M are companies that set aside a percentage of time or days for innovation. For example, 3M and Google allocate 10 percent of time for pursuing innovations, while Atlassian holds “FedEx” days where something of value must be delivered 24 hours later. The time allotted doesn’t matter as much as the discretionary authority provided to the individual.

The right infrastructure balances knowledge-sharing and free time with formal projects using results-oriented and idea-oriented metrics. Metrics encourage calculated risk-taking and accommodate the flexibility required with innovation projects. Ideas will be refined, requirements will change, priorities will shift, and resources will be reallocated based on the metrics. The

## THE COMPETENCY WHEEL

This competency wheel depicts the six nontechnical skills that are key to internal audit innovation as well as the three enablers for those skills.





appropriate metrics will vary for each organization, depending on its current culture, skills, and infrastructure. However, there are a few criteria that internal audit departments can use to determine the sufficiency of their metrics. Generally, metrics should:

- ➔ Support the focus on business acumen and stakeholder concerns

For a sustainable, innovative environment, all three pillars must be in place. Having innovative-minded individuals without an innovative culture or infrastructure will result in frustration, disengagement, and turnover. A department that has an innovative culture and a supportive infrastructure, but lacks the necessary skills, will still be limited.

## Auditors must be inquisitive thinkers who generate fresh insights.

by measuring contribution to risk management, thought leadership, and management discussions.

- ➔ Encourage individuals to deliberately explore new concepts using educational metrics.
- ➔ Encourage expanded networking and experiences using management relationship metrics.
- ➔ Encourage the sharing of lessons learned on successful and failed projects using continual improvement metrics.
- ➔ Measure operational impact using metrics that gauge the pipeline of new ideas that improve operational performance and the level of adoption by the business.
- ➔ Tie to performance plans or balanced scorecards to balance investments with accomplishing business objectives.
- ➔ Tie to rewards. Used discriminately, symbolic rewards and nominal monetary incentives can spark engagement. Business leader nominations and evaluations can serve as an input into the awards. Considering levels of innovation when nominating individuals for participation in leadership development programs and internal initiatives also provides a reward.

Employees will not be able to use knowledge and collaboration tools to their full abilities. Auditors will not be equipped to delve deep enough or wide enough during problem-solving and root-cause analysis to achieve meaningful results. If the department has the skills and culture but hasn't put in the right infrastructure, it will lack the information needed to focus its efforts. As a result, it won't spend its time in the most productive and efficient way. If internal audit leaders aren't sure they have all three elements in place, a quick assessment may be in order. Start by rating internal audit on eight factors:


1. We know where we fit in the organization's value chain.
2. We include creative thinking and innovation in our day-to-day responsibilities.
3. We have effective processes for identifying and analyzing new trends or technologies.
4. Our team is effective at capturing, acknowledging, and synthesizing new ideas.
5. We openly share information with our stakeholders.
6. People have opportunities to work with, and learn from, other groups.
7. People have opportunities to develop innovation skills.

8. People have free time allocated to work on innovation projects.

### GETTING STARTED

The trial-and-error approach is the best way to step into innovation. Internal audit departments should avoid the temptation to spend months assessing and analyzing. Instead, they should model innovation within their approach to becoming innovative. Consider these innovation kick-start options:

- ➔ **Innovation Board.** Let people select an opportunity from an innovation board, hold their own innovation sessions, and select a change to implement.
- ➔ **Jam Session.** Hold a jam session to voice frustrations and problems. Listen to identify themes, rather than to disprove anything. Listen for tension language such as "either/or" that may represent self-imposed constraints. What happens if you drop the either/or assumption?
- ➔ **Open Forum.** Use social media to collect thoughts, within the organization initially, about how the department could resolve issues.

Internal audit's ability to provide value in a rapidly changing, complex business environment requires an innovative mind-set. Auditors must be inquisitive, associative thinkers and learners who grapple with the issues that matter to their organizations and generate fresh insights that challenge management to think in new ways. Embedding sustainable innovation into an internal audit department's system is hard work. However, once auditors imagine the possibilities and begin taking steps toward realizing them, the momentum they establish is hard to stop. 

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