

## **Internal Audit in the Age of Digital Transformation**

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The acceleration of digitalization in business is transforming internal audit at a rapid rate. Like their business stakeholders, internal auditors are trying to figure out how the changes in technology and the business environment are affecting organizations and how to beneficially harness and leverage the opportunities generated by digitalization.

Internal audit professionals in Canada are hardly operating in a digital backwater, particularly given the important role that BlackBerry Ltd., a company founded in 1984 in Ontario, had in developing mobile technologies. By producing a pager capable of email in 1999 and a smartphone in 2002, BlackBerry helped establish Canada as a hotbed of technology incubators. As those centers of innovation continue to produce new technologies that remake the corporate operating and compliance landscape, here are three big concepts internal auditors need to get right as they strive to adapt to digitalization and changing customer expectations:

### **Understand the Difference Between Digitalization and Automation**

Responding to an informal poll during a recent Protiviti internal audit webinar on digitalization, nearly three-quarters of more than 1,000 participants affirmed that the internal audit function in their organizations understood the concept of digitalization. However, digitalization is often conflated with the more fundamental business process automation, and I would wager that at least some of those affirmative respondents were unsure about the difference. In some cases, even those leading their businesses in what is termed a digitalization initiative may not be entirely familiar with the distinction.

Automation typically simplifies a process to improve efficiency and effectiveness, which often results in cost savings – for example, replacing mailed paper statements with email or other electronic solutions to deliver bills or invoices. Digitalization is the adoption of technology to radically improve the performance and reach of an enterprise to generate efficiencies and create new revenue opportunities. A true and effective digitalization strategy permeates every part of an organization and typically utilizes cloud computing, social media, mobile technology, big data analytics, artificial intelligence and the internet of things, to name a few technologies. Adopting digitalization requires companies to embrace a change of their entire culture – not just of one or a few processes. Those that try to compartmentalize digitalization are more likely to miss growth opportunities.

Consider Blockbuster, the one-time preeminent video rental store chain. When Netflix challenged Blockbuster's business model by allowing consumers to rent DVDs by mail, Blockbuster launched a similar distribution service. But a limited technological expansion, store leases and difficulty apportioning revenues bogged down the company, leaving it incapable of pursuing the type of emerging digital strategies and streaming services that have dramatically altered the way people watch movies and television. Meanwhile, some media companies have addressed the changing content-delivery

environment by leveraging social media to generate buzz about their products and expanding the number of consumer channels to mobile devices.

And digitalization doesn't apply solely to industries invested in technology. In many cases it is disrupting the most conventional and seemingly established industries by creating demand where none existed before. Case in point: Organizations such as Airbnb and Uber have used digital solutions to make sweeping changes to the taxi and hospitality industries. Not only can people use mobile applications to order rides and lodging without opening their wallets, but they can also make money by providing the transport or housing on the other side of the transaction. Had digitalization been limited to just one side of the transaction, the transformative effect on the industry would have been much smaller. This is a textbook case where the possibilities offered by technology have been explored for maximum advantage, elevating peer-to-peer services to a successful digitalization strategy.

### **Fully Understand Your Organization's Digitalization Strategy and Risks**

Auditors need to ensure that they clearly comprehend the scope and aim of their organization's digitalization efforts, and the best way to achieve that is to assume an involved and informed role within the organization, as expressed in the expectation of internal audit stakeholders in The Institute of Internal Auditors' [Common Body of Knowledge Stakeholder reports](#). Auditors must determine whether their organization is following a broad and cohesive digitalization strategy or pursuing a number of small efforts that need to evolve into such a strategy. Because digitalization enables companies to collect and analyze virtually millions of pieces of information on customers, operations and processes, auditors need to recognize how the associated risks could affect the organization operationally and strategically. Most important, they need to communicate that information to the board and executive suite so that executives can make thoughtful decisions about their capacity to mitigate potential threats.

Auditors should also be aware of risks that arise with digitalization. IT risks will be amplified in business functions and may appear in areas that may not have received priority attention in the past – for example, marketing and customer service, where massive volumes of sensitive data (e.g., social security/social insurance numbers, incomes, health records, buying preferences) are collected, processed and stored. Operational risks may intensify, causing pressure on prices and margins due to near-perfect transparency and competition from new market entrants. Organizations may face talent mismatches and shortages as digitalization encroaches on a growing number of knowledge roles based on synthesizing information, and business models will need to evolve as organizations strive to keep pace and stay ahead in the marketplace. Internal auditors need to stay abreast of their organizations' digitalization initiatives and strategy, assessing their impact on business unit objectives and reviewing relevant policies overseeing cybersecurity, privacy and information governance to verify they are still sound and in tune with new or changing business processes.

When assessing these areas, auditors need to be cognizant of an organization's risk profile, which may be influenced by industry, regulation, mission and other variables. In some cases, auditors may need to point out that digitalization is creating risks that the organization is unaware of; in others, auditors may need to discuss the risk boundaries of management that could put them at a competitive disadvantage.

### **Build Digital Skills**

Responding to other informal poll questions, just over half of the participants in Protiviti's digitalization webinar said that they had begun discussing how digitalization was affecting audit plans. But nearly two-thirds said that they either did not have the skills or did not know if they had the skills to assess digitalization strategies.

Those results are not surprising, digitalization is creating a steep learning curve for internal auditors that will take some time to climb. There is a knowledge gap between what organizations are doing to achieve their digitalization objectives and the technical and analytical skills of auditors to draw up and execute audit plans that effectively evaluate the risks produced by these initiatives. It is critical that auditors embark on training programs to develop new technical skills, and, in some cases, bring in specialists to fill the gaps. Often, those specialists may already exist within another department of the internal audit team's organization – for example, IT or data analytics. It pays to seek internal expertise and collaboration first before turning to external sources.

### **In Conclusion**

Digitalization is hastening an evolution that is expanding the role of internal audit. Whereas, traditionally, auditors have focused on their oversight role to ensure that protocols for processes, controls, resources and performance measures are being followed and are yielding expected results, it is now almost routine for stakeholders to ask auditors for their **insight** into processes and risks as organizations advance their digitalization strategies. But auditors need to move even further and develop **foresight** to determine whether an organization is capable of addressing future risks as its digitalization program evolves, scales for future growth, or requires other adjustments.

To provide their insight and foresight, auditors need to ensure that they understand digitalization and its effect on the current and potential future risks. They must develop the skills to effectively evaluate digitalization risks and better understand the related risk responses. Internal audit teams that grasp digitalization's potential will be in the best position to provide value to their organizations in an environment where disruption has become the rule rather than the exception.