Human Capital Diagnosis in a Digitized Environment: An Internal Audit perspective
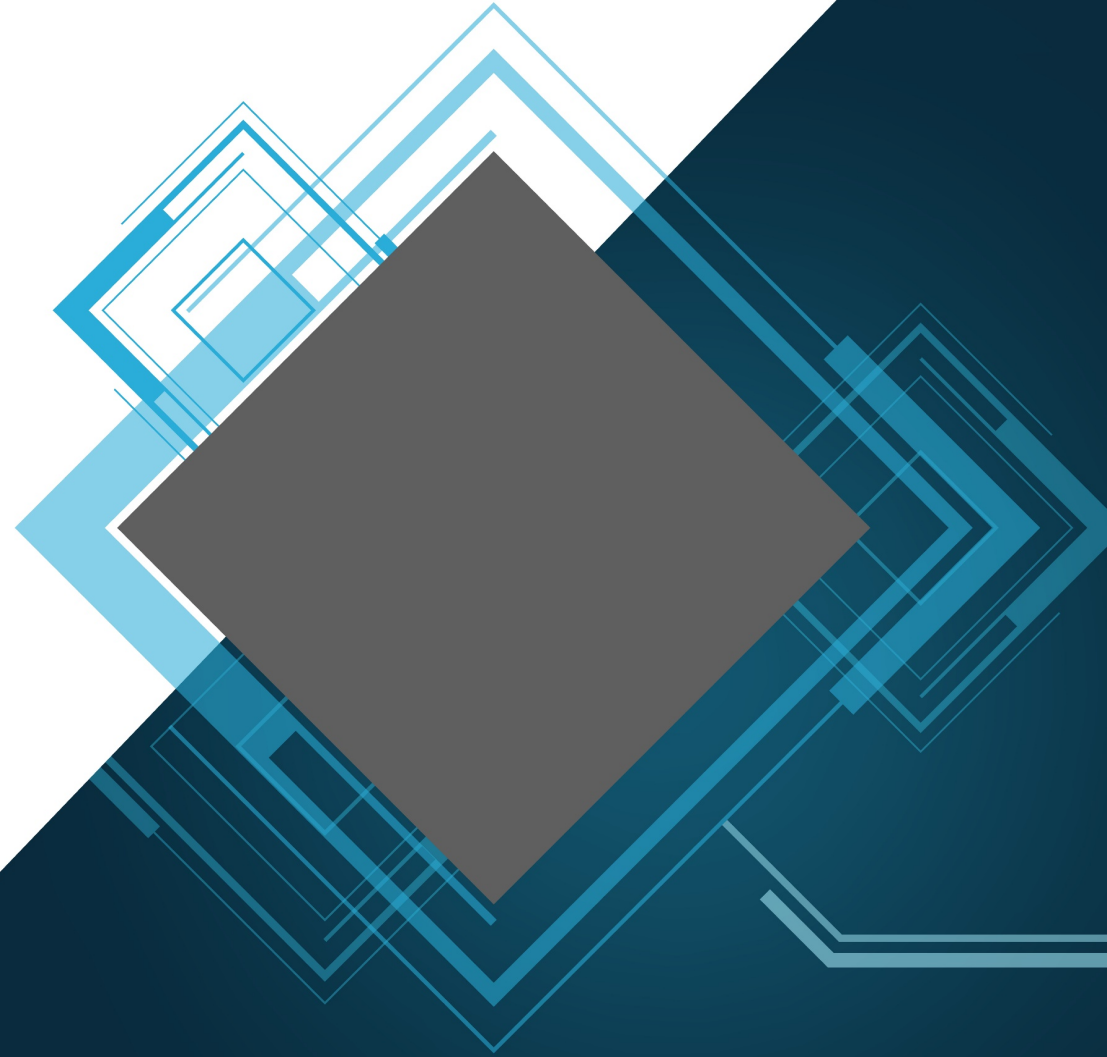
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Agenda

A diagnosis of challenges, and better practices related to Human Capital.

Digitization stories.

Internal Audit's role in supporting the entity by protecting its most valuable resource, Human Capital, while playing a key role in the promotion of the digitization of activities whose automation is the only way forward.

"Never in all history have we harnessed such formidable technology. Every scientific advancement known to man has been incorporated into its design. The operational controls are sound and foolproof"

Captain E.J. Smith of the Titanic prior to its maiden voyage

Elon Musk, referring to SpaceX

Or

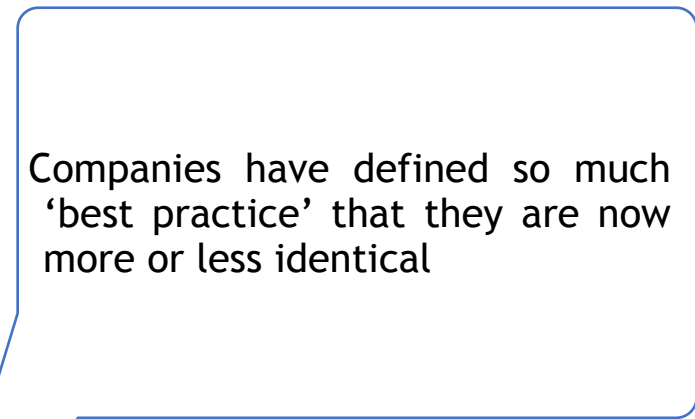Richard Branson, referring to Virgin Galactic

A diagnosis of challenges, and better practices related to human capital.

Digitization Stories.

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First, Let's Agree …
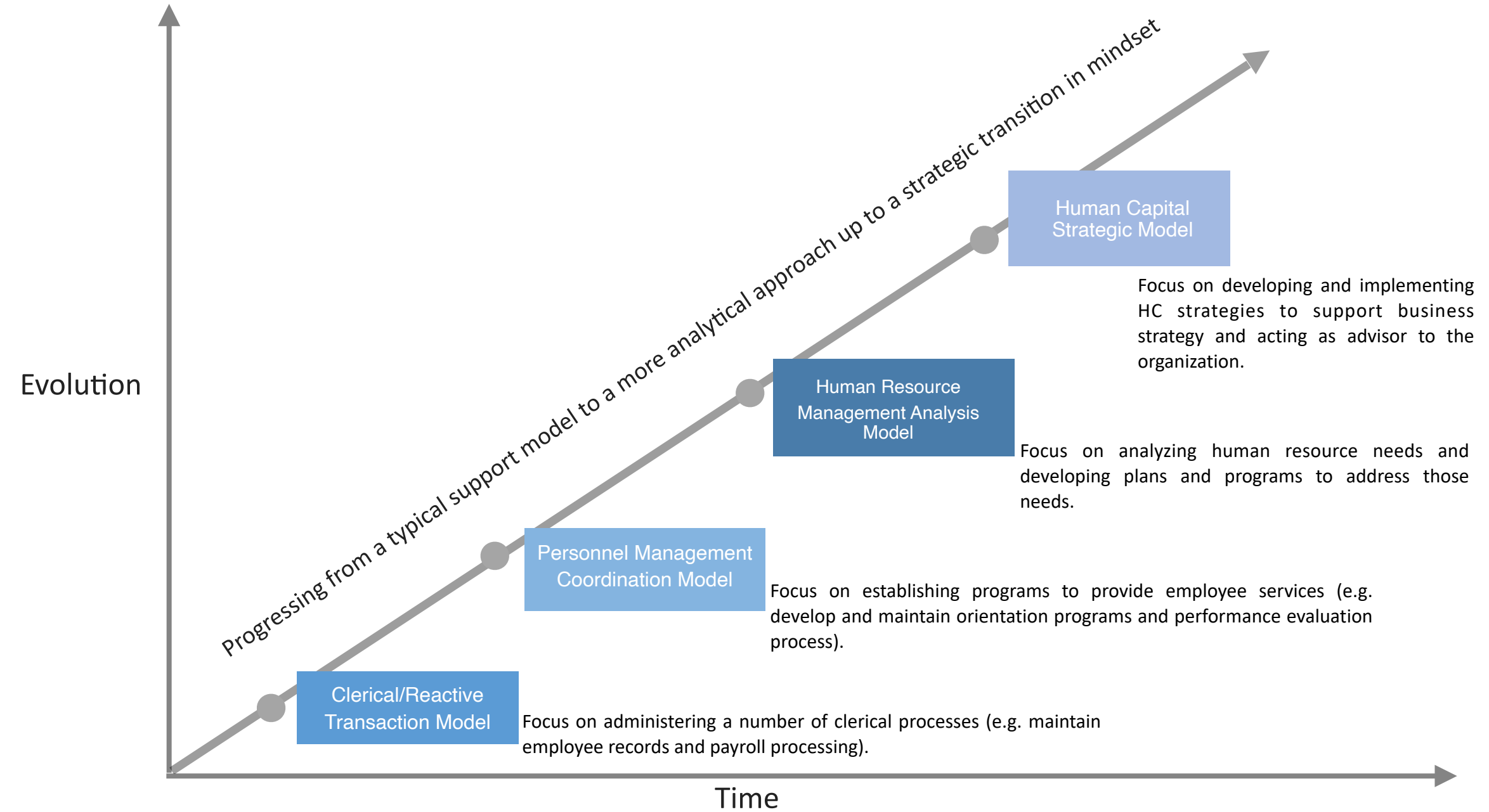
Best practices are not about what others are doing … They are efforts that exhibit world-class results, thereby encouraging initiative in solving business challenges in areas such as competitive advantage, financial impact, innovation, and managing change, among others…
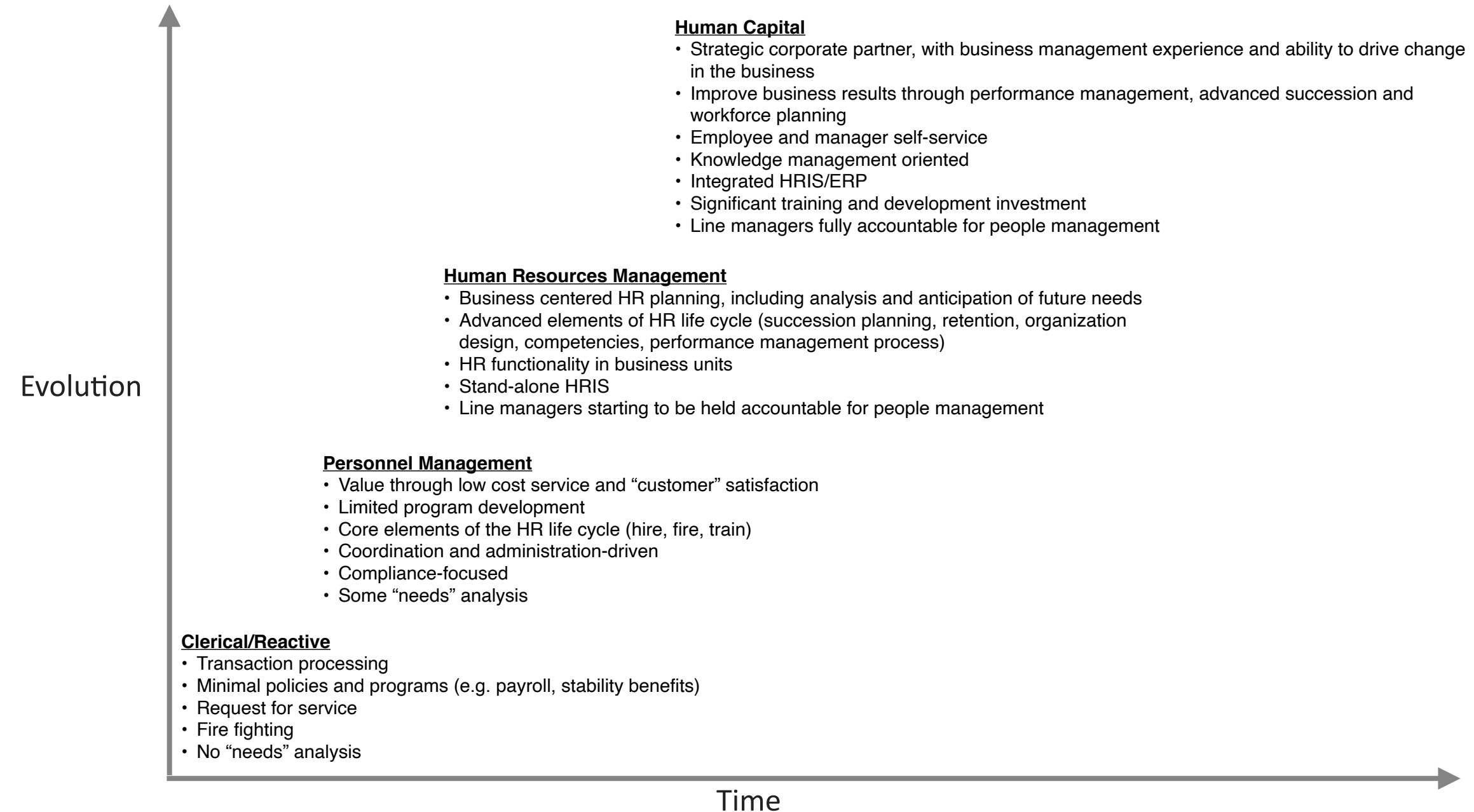
Companies have defined so much 'best practice' that they are now more or less identical

Jesper Kunde

Context: From Personnel Affairs Clerking to the concept of Human Capital

Evolution (y-axis) / **Time** (x-axis)

Progressing from a typical support model to a more analytical approach up to a strategic transition in mindset

Human Capital Strategic Model
Focus on developing and implementing HC strategies to support business strategy and acting as advisor to the organization.

Human Resource Management Analysis Model
Focus on analyzing human resource needs and developing plans and programs to address those needs.

Personnel Management Coordination Model
Focus on establishing programs to provide employee services (e.g. develop and maintain orientation programs and performance evaluation process).

Clerical/Reactive Transaction Model
Focus on administering a number of clerical processes (e.g. maintain employee records and payroll processing).

Context: From Personnel Affairs Clerking to the concept of Human Capital - Continued

Evolution (vertical axis)

Time (horizontal axis)

Human Capital
- Strategic corporate partner, with business management experience and ability to drive change in the business
- Improve business results through performance management, advanced succession and workforce planning
- Employee and manager self-service
- Knowledge management oriented
- Integrated HRIS/ERP
- Significant training and development investment
- Line managers fully accountable for people management

Human Resources Management
- Business centered HR planning, including analysis and anticipation of future needs
- Advanced elements of HR life cycle (succession planning, retention, organization design, competencies, performance management process)
- HR functionality in business units
- Stand-alone HRIS
- Line managers starting to be held accountable for people management

Personnel Management
- Value through low cost service and "customer" satisfaction
- Limited program development
- Core elements of the HR life cycle (hire, fire, train)
- Coordination and administration-driven
- Compliance-focused
- Some "needs" analysis

Clerical/Reactive
- Transaction processing
- Minimal policies and programs (e.g. payroll, stability benefits)
- Request for service
- Fire fighting
- No "needs" analysis

What Does a Comprehensive and Agile Human Capital Framework Look like?

Enabling Practices

Enabling Practices

Enabling Practices

Human Capital Governance

Strategic Direction

Effective, Relevant, Reliable Evaluation and Performance Measurements

Programs and Policies

Enabling Practices

Enabling Practices

Enabling Practices

Each Component is Enabled Through a Number of Key Leading Practices

Human Capital Governance	Strategic Direction	Effective, Relevant, Reliable Evaluation and Performance Measurements	Program Policies
• Positioning • Values • Ethics • Human capital vision and strategy supported by those charged with governance	• Vision Statement and Critical Success Factors • Long term and annual Human Capital strategic plan • High performance culture	• Performance measurement • Accountability • Continuous improvement • Monitoring results	• Compensation • Attraction and retention • Training and development • Succession planning

Human Capital Governance
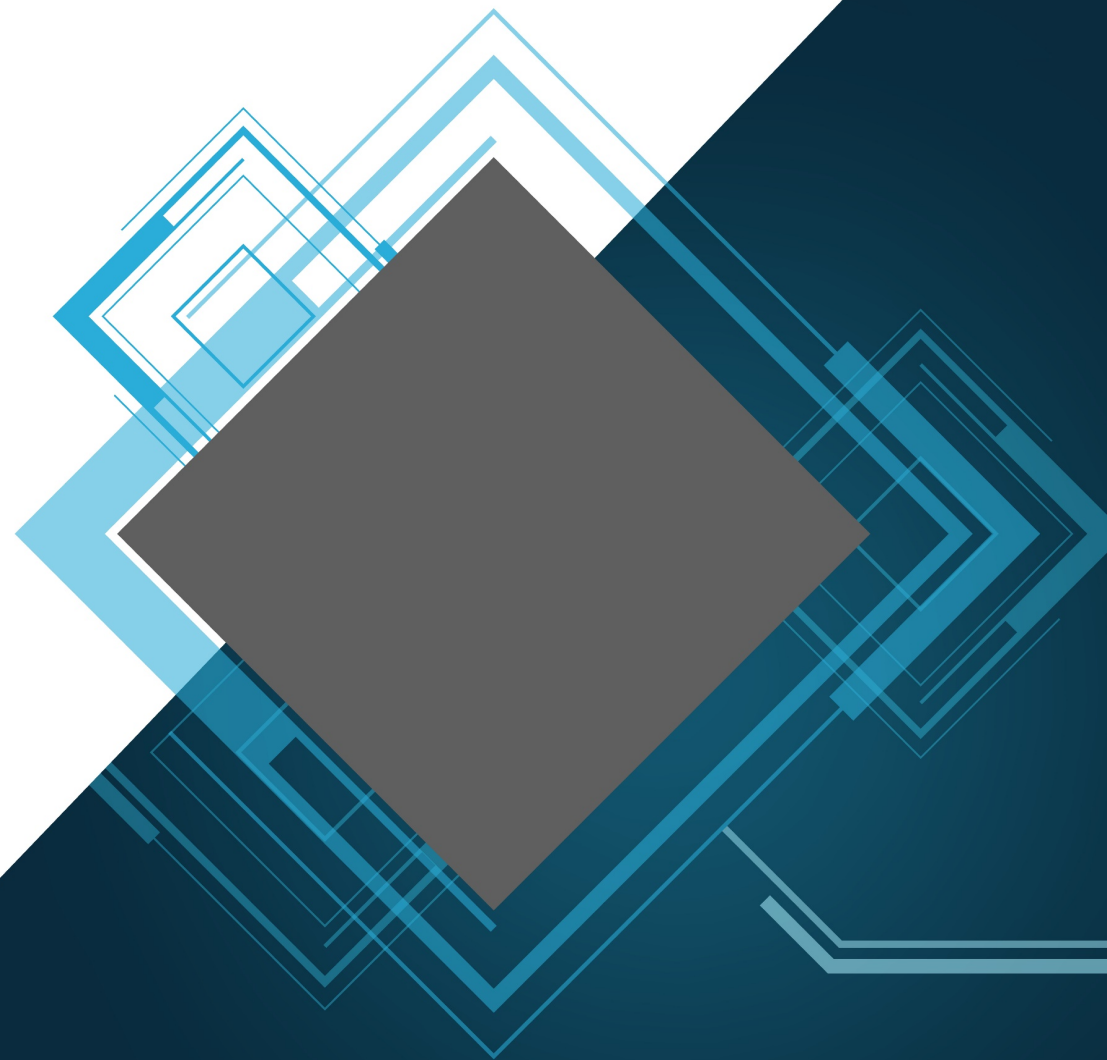
Human Capital Governance: Key Challenges and Risks

Positioning	Values	Ethics	Human Capital vision and strategy supported by those charged with governance

Positioning
- Human Capital leadership is reduced to a 2nd tier in comparison to a first tier/CXO stature
- Human Capital leadership is not invited to strategic and other critical undertakings
- No seat at any relevant table

Values
- Corporate values are vague and inappropriately articulated
- Immediate results by teams carry more weight than demonstrated behaviors by employees that affect the longer-term

Ethics
- The ethics framework and related training are weakly emphasized and provided
- Most employees have either never attended ethics training or only attended upon induction
- Familiarity with corporate ethics is never tested or surveyed

Human Capital vision and strategy supported by those charged with governance
- An up-to-date HC vision statement and articulated HC strategy have not been defined
- HC strategic direction is provided to some degree by executive management, yet systematic corporate-wide awareness and implementation have not occurred

Human Capital Governance: Key Leading Practices

| Positioning | Values | Ethics | Human Capital vision and strategy supported by those charged with governance |

- A Chief Human Capital Officer role is established; at the minimum, a SVP Human Capital Role
- The Human Capital Function is a key part of the senior leadership of the organization
- The Human Capital Function has a close relationship with the Compensation and the HR & Nomination Committees of the Board of Directors

- The HC function seeks to foster an environment that supports the physical, psychological and social well-being of employees
- Culture change that builds on the current positives and enhances the organization's capacity for change and risk taking, encourages effective decision making and promotes organizational teamwork

- Meaningful ethics that are operationalized e.g. embedded in the framework and communications
- Training is delivered on responsible decision making, how integrity and responsible business conduct tie in with organizational objectives, and how to communicate about integrity and its impact on organizational performance
- Clarity of procedures by which potential issues can be raised, discussed, and reported without fear of retaliation
- Leaders and supervisors demonstrate ethical fortitude and business acumen
- Willingness of employees to report misconduct and satisfaction with organizational response to reports of misconduct

- The Human Capital vision is aligned with the business and is contextually relevant. The vision statement encompasses elements such as the desired culture and people effectiveness
- The vision is supported by senior leadership
- Vision and strategy are communicated across the organization

Strategic Direction
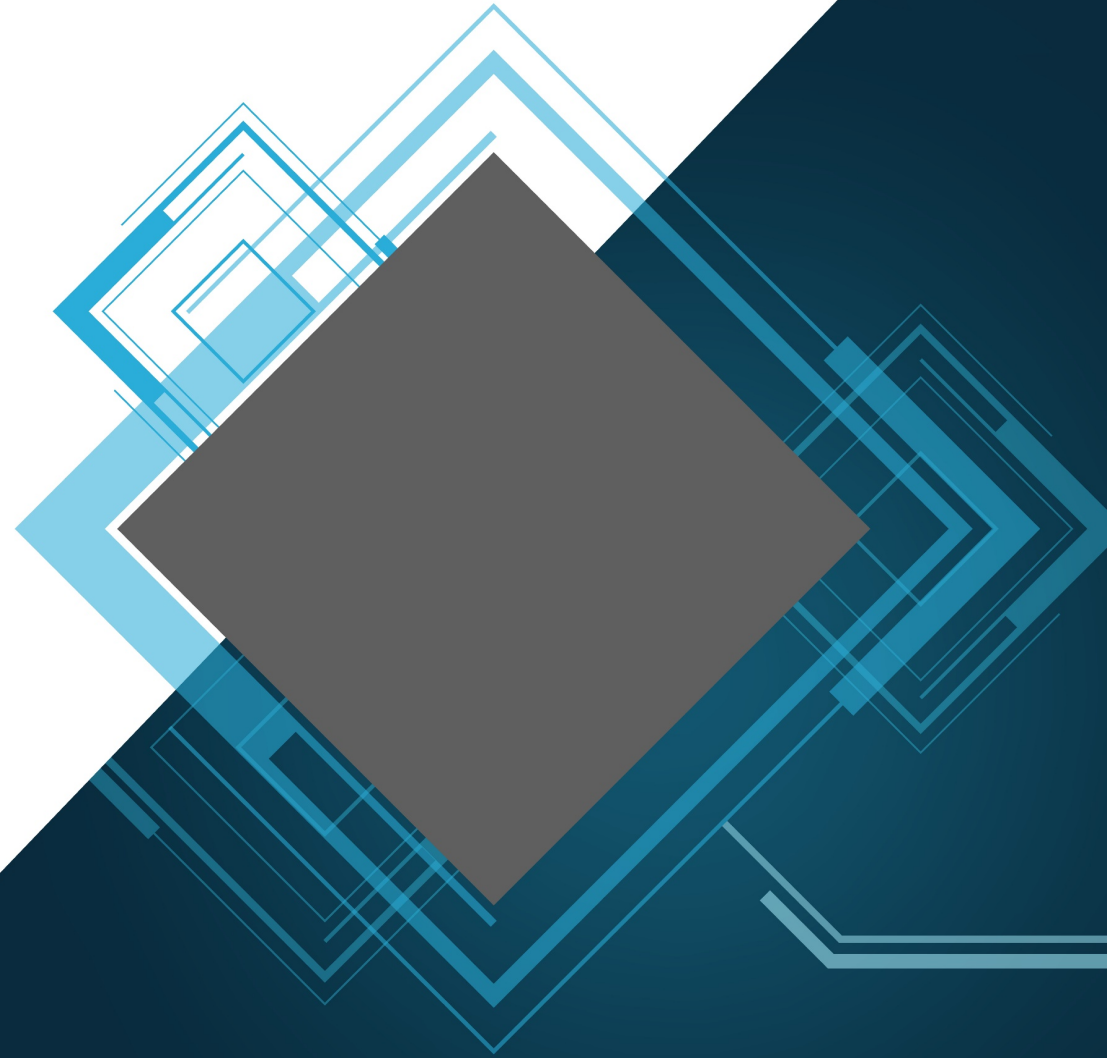
Strategic Direction: Key Challenges and Risks

Vision Statement and Critical Success Factors	Long term and annual Human Capital strategic plan	High performance culture

Vision Statement and Critical Success Factors

➡ No participation by the HC team/not solicited during the business strategy formulation

➡ A lack of a HC strategy based on organizational priorities

➡ No involvement in business strategy implementation

Long term and annual Human Capital strategic plan

➡ Limited or no efforts to align HC planning process/ environmental scan to synchronize with and feed the corporate planning process

➡ Little consistency in HC planning (e.g. identifying client needs, data gathering, analysis, program development and evaluation). No real longer-term action plans

➡ Recognized need for more strategy and discipline in setting priorities to identify business needs

High performance culture

➡ Too wide a gap in terms of risk appetite from one extreme to another (risk averse to avid risk seeking culture)

➡ Reluctance to directly address low performance employees

➡ Accountability/rewards for HC effectiveness given minimal attention and priority (i.e. managers are recognized for business results, less so for people management)

Strategic Direction: Key Leading Practices

Vision Statement and Critical Success Factors

Long term and annual Human Capital strategy

High performance culture

- A proactive and integrated approach to human capital planning
- A HC service delivery model that incorporates analysis of internal trends and demographics and internal and external sound practices that have proven to work
- A HC planning approach that is aligned and integrated with business planning
- HC programs and initiatives that are integrated and encourage high performance

- Defined organizational HC strategy
- Established employee value proposition
- Specific objectives and expected outcomes (e.g. for talent acquisition, development, performance management, rewards, etc.)
- Defined metrics are developed and authorized to assess the success of the HC strategy
- HC enablers are identified and implemented. These include the various factors that enhance the organization's ability to effectively assess, design, implement and manage organizational and people effectiveness objectives, policies and action plans. These may include corporate and HC leadership, middle and line management, technology, strategic and annual planning, and performance measurement and management

- Results focused culture, but not at any cost, with clear accountabilities
- A robust knowledge creation and sharing culture where information is shared, and openness and trust are fostered
- Conflicts and performance issues are addressed and unfulfilled commitments are exposed/justified
- A well-aligned performance-based rewards strategy

Effective, Relevant, Reliable Evaluation and Performance Measurements
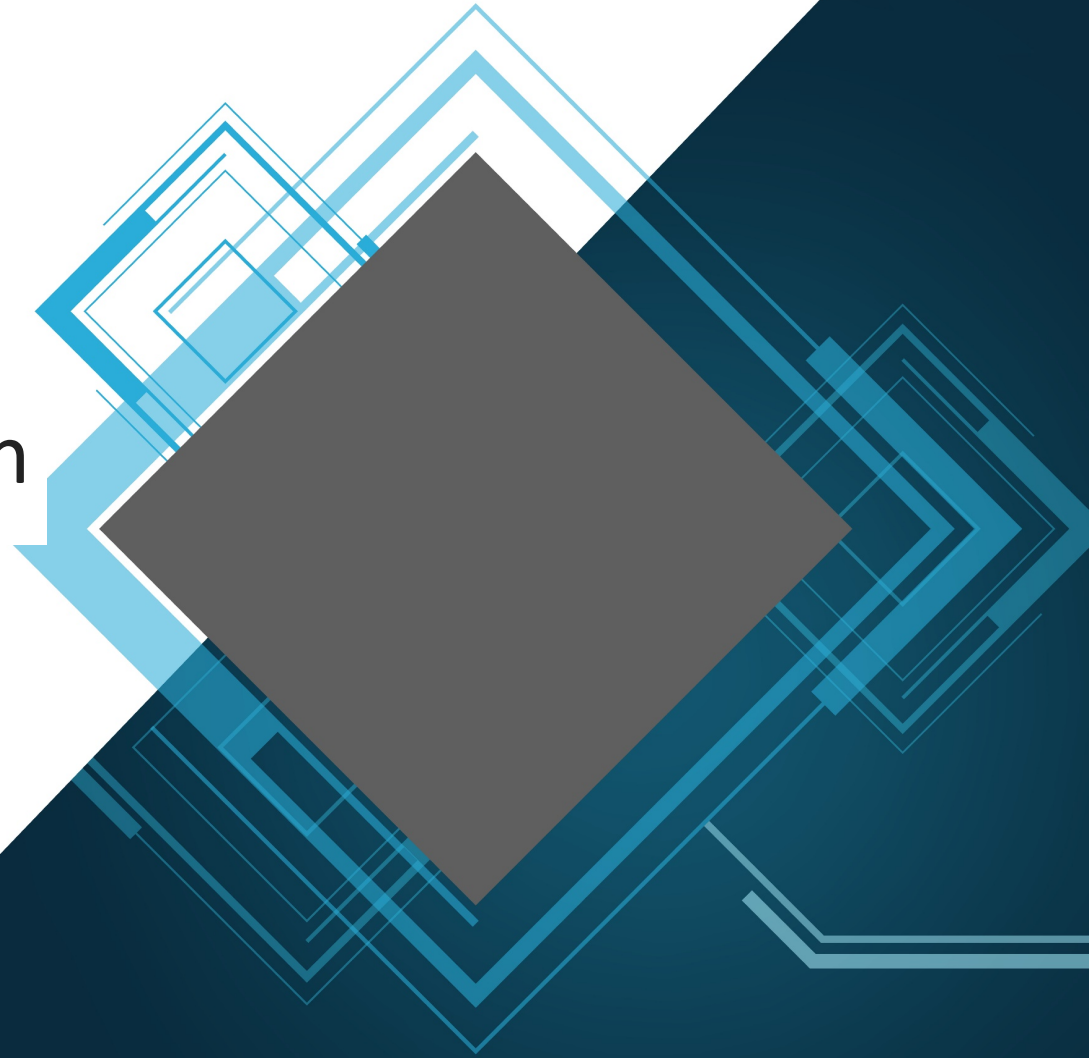
Effective, Relevant, Reliable Evaluation and Performance Measurements: Key Challenges and Risks

Performance Measurement

- Performance appraisals are completed annually, yet ongoing feedback is inconsistently followed

- The weighting of competencies in determining performance ratings and related pay adjustments is applied in an ad hoc manner that differs from one appraiser to the other

- The focus tends to be on business results with inconsistent application of the "how" component

- Differentiation between low and high performers is not optimal. The full spectrum of the implemented rating scale is not employed

- Developmental plans are not consistently prepared. There is some reluctance to formally document areas for improvement

- Intent, tools and methodology are in place but are inconsistently executed across the organization

Accountability

- Insufficient needs analysis prior to program implementation

- Line management accountability for People/HC effectiveness less then optimal and not systematic

- Managers are not consistently assessed and held accountable on executing human capital practices. There are no incentives for being accountable. Rewards/recognition for managing people is not recognized

- Immediate results by teams carry more weight than demonstrated behaviors by employees that affect the longer-term

Continuous Improvement

- No rigorous or systematic review process in place. Feedback or follow-up is done informally, or where formal, on an ad hoc/context–specific basis

- HC is continually undertaking improvement initiatives in relation to program delivery. A gap exists in linking these initiatives to a longer-term integrated strategy and building a solid business case for change

Monitoring Results

- Gaps in terms of the overall picture/framework within which the programs whose results are tracked

- There is no formal, systematic approach to monitoring and measuring HC programs/processes - a reluctance to survey employees limits the ability of a broader assessment of performance in relation to programs and practices

Effective, Relevant, Reliable Evaluation and Performance Measurements: Key Leading Practices

Performance Measurement

- A standard individual development plan template for each employee is completed, listing specific goals, assignments, training courses, projects, and other developmental activities with projected completion dates to add structure

- Supervisors are encouraged to participate in the goal-setting process by providing constructive feedback on (_not evaluation of_) performance strengths and areas of developmental weaknesses

- Identify "master achievers" in each core competency area through manager meetings, and conduct performance appraisals of employee competencies against these top performers; consequently, improve core competency definitions by observing behaviors of top performers in each competency area and incorporating those behaviors into ideal competency models

- Notify lowest 10% of performers in each function and place them in a performance improvement plan to help them rise above this level

- Base a percentage of managers' yearly bonuses on the management and development of low performers in their division/function

- Transfer chronic low performers into more suitable positions or terminate and seek replacements

Accountability

- Roles and responsibilities are clearly defined

- Program/process owners are held accountable for related outcomes and take necessary corrective actions

Continuous improvement

- Measurement and monitoring are used to communicate results, target areas for improvement and focus investments for change

Monitoring results

- Core programs and processes are formally documented

- Core programs and processes are monitored to measure efficiency and effectiveness

Program Policies
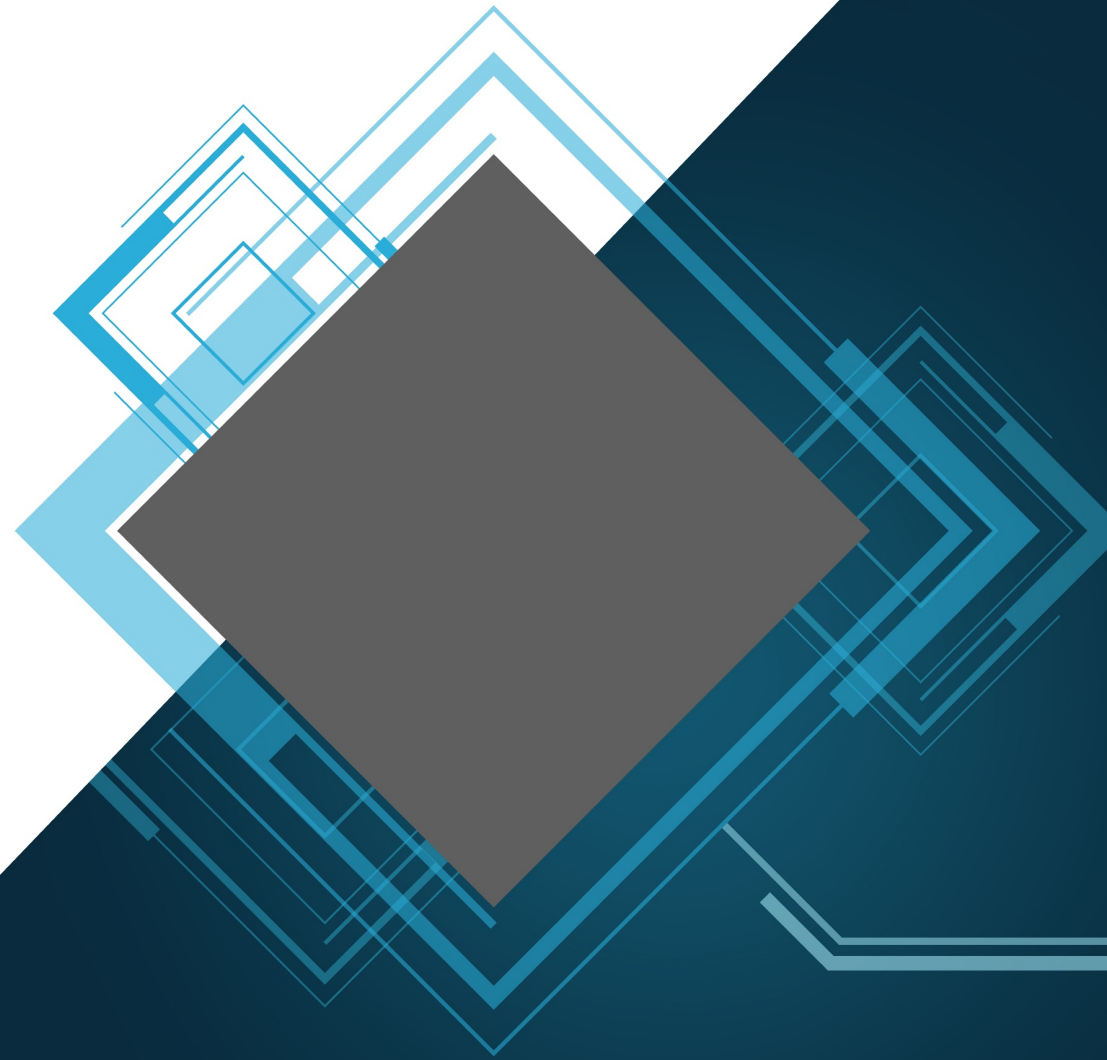
Program Policies: Key Challenges and Risks

Compensation

- Limited or no clarity in employee understanding of those factors affecting compensation increases and bonus payments

- Pay and rewards not tied to performance, which leads to a progressive decrease in work quality and of employee desire to develop skills and competencies

- The disconnection between bonuses and business performance hampers employees' understanding of organization's financial performance

- The lack of creative initiatives such as rewards programs that would be based on accrued points, and that aid in retaining employees and reducing turnover

Attraction and Retention

- A large number of employees that leave are younger employees who cite a lack of career advancement as the primary reason for departure. A retention strategy for this 'new generation' of employees required for workforce renewal, has not been developed and implemented

- Internal lateral mobility is quasi inexistent

- A weak employment brand exists, thus hampering an integrated recruitment strategy

- Employees are not offered flexible work arrangements, or opportunities for early retirement or from stepping down from positions in advance of retirement, etc. thus allowing a healthy turnover in employees and offering advancement opportunities

Training and Development

- Training and development budgets are not strategically linked to the broader business goals; this is a translation of the fact that individual training and development is not optimally linked with broader business goals and individual career planning

- Minimal coaching and mentoring, and ad hoc practices exist in certain projects, geographies or functions

- There is a need to move beyond awareness with regard to diversity into a more integrated understanding and operationalization of diversity programs

- A Leadership Development Program has not been established, or is barely implemented yet it does not link to Succession Management and Talent Management needs

Succession Planning

- A leadership succession planning program is inexistent

- There is a departure from the need to ensure knowledge transfer and to invest in the development of future leadership candidates

- Critical jobs and their respective career paths have not been identified

Program Policies: Key Leading Practices

Compensation

- A three factor approach is implemented to create an employee's "pay equation" and to establish employee compensation levels: market pricing, individual merit based evaluation, and performance/competency based evaluation

- Employees across the organization are provided with all information regarding compensation policies and procedures via the company's intranet to assure clear communication of compensation guidelines

- A certain percentage of managers' annual bonus is linked to a "leadership index", determined by an anonymous survey of the manager's direct reports on how they rate his/her performance

- A periodic pay-for-performance (e.g. weekly) incentive program for employees is instituted, by which employees receive a related period salary bonus for exemplary service

- Employee incentive payments are linked to the organization's business results to improve work quality and to raise awareness of overall business performance amongst the employee population

- A standardized compensation schedule is implemented, whereby performance reviews, compensation increases, and bonus payments occur at pre-set coordinated times during the year for each job function

- An incentive program is instituted, whereby employees earn rewards points for superb performance, perfect attendance, employee referrals, etc, and where employees can redeem accrued points for rewards listed in a "rewards catalog" and can monitor accrued points via the company intranet

Attraction and Retention

- Organization-wide Internal Mobility Programs exist, and career mobility is regularly provided

- Promotions are revised systematically, decisions are made based on workforce planning needs, predefined career paths, and competency-based performance managed processes

- Formal retention programs are in place

- Career paths exist and are accessible to employees

- A strong employer brand exists

- Flexible work arrangement programs are established and well communicated

- Formal separation program is in place with direct and anonymous exit interview response channels

Program Policies: Key Leading Practices - Continued

Training and Development

Succession Planning

- External vendors – classroom instructors, instructional designers, web developers – are retained to design extensive online learning and development resources

- A learning team consisting of learning consultants and IT representatives to research and implement new e-enabled courses and technology

- A tiered learning system consisting of face-to-face learning sessions, online discussions, online interactive training, and online training information is established

- A variety of face-to-face career support options, such as career counseling sessions, skill assessment workshops, and personal development plan assistance, are established to complement online learning tools

- Strategic and leadership-focused training as well as technical and operational training are provided

- Assistance with tuition reimbursement, based on set criteria

- Putting the HC function in the hands of managers and employees with HC as the change agent and facilitator. Qualities, knowledge, skills, training, and competencies required by employees to perform functions and tasks that are crucial for company goals are tracked

- Managerial succession planning systems that shift from "position-person matching" models to more flexible systems that are responsive to a climate of rapid and unpredictable change and discontinuity. Elements include:

  - Establishing a formal, long-term succession plan at CXO and upper management levels

  - Creating pools of positions with common required competencies

  - Revisiting/updating succession plans annually

  - Using a multi-dimensional selection process with tangible criteria for evaluating abilities and accomplishments

  - Looking outside the company for candidates

  - Establishing action plans for individual candidate development

  - Establishing coaching/mentoring programs

A diagnosis of challenges, and better practices related to human capital.

Digitization Stories.

Internal Audit's role in supporting the entity in protecting its most valuable resource, Human Capital, while playing a key role for the digitization of activities whose automation is the only way forward.

Introduction: Facts & Figures

2025*

Percentage of businesses surveyed who indicate that they are set to reduce their workforce due to technology integration — **53%**

Percentage of businesses surveyed who indicate that they are set to reduce their workforce — **15%**

Percentage of businesses surveyed who indicate that they are set to increase their workforce due to technology integration — **34.5%**
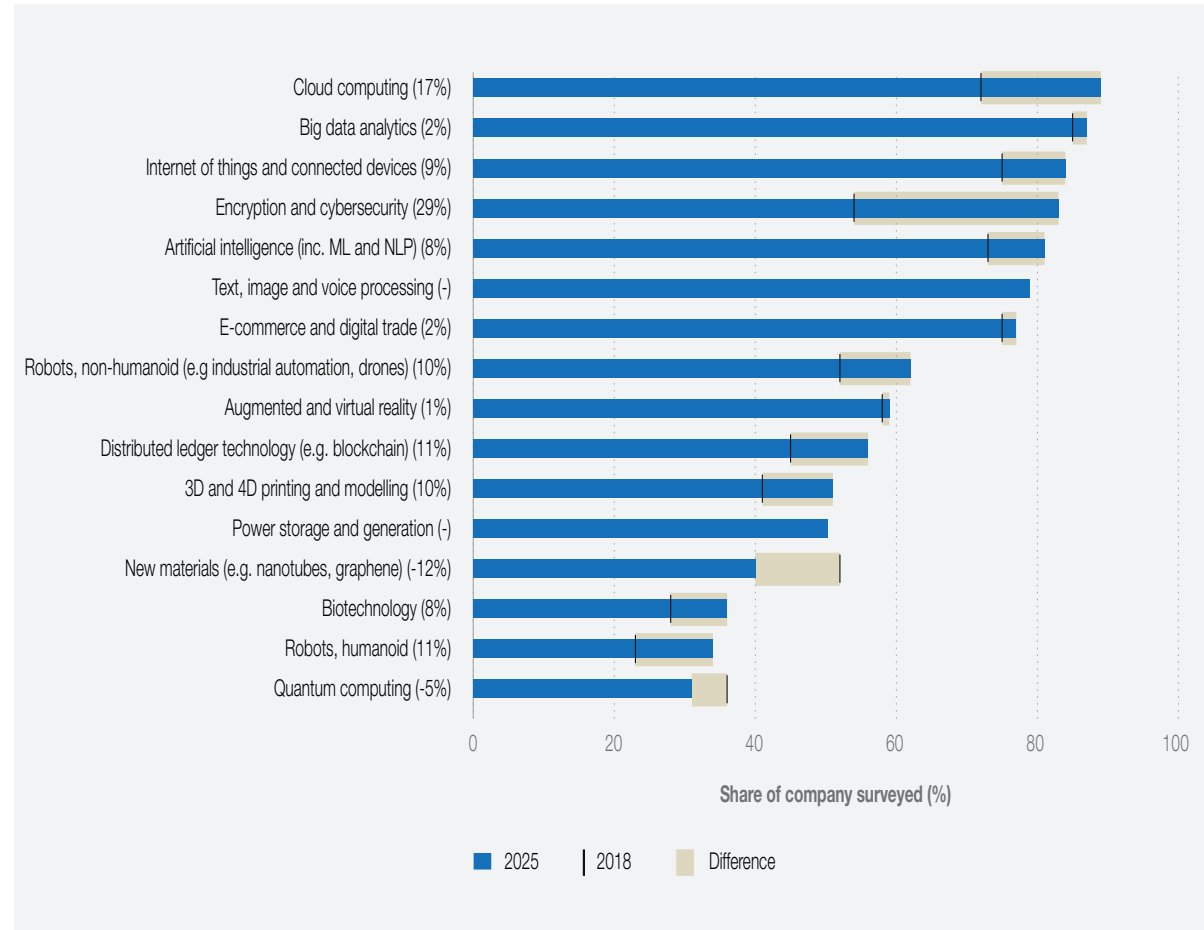
Percentage of employers expecting their employees to pick up new skills — **50%**

Share of core skills that will change in the next five years — **40%**

The figure below presents the share of current tasks at work performed by human vs. machine in 2020 and forecasted for 2025 according to the estimates and planning of senior executives today*

Technology	
Cloud computing (17%)	
Big data analytics (2%)	
Internet of things and connected devices (9%)	
Encryption and cybersecurity (29%)	
Artificial intelligence (inc. ML and NLP) (8%)	
Text, image and voice processing (-)	
E-commerce and digital trade (2%)	
Robots, non-humanoid (e.g industrial automation, drones) (10%)	
Augmented and virtual reality (1%)	
Distributed ledger technology (e.g. blockchain) (11%)	
3D and 4D printing and modelling (10%)	
Power storage and generation (-)	
New materials (e.g. nanotubes, graphene) (-12%)	
Biotechnology (8%)	
Robots, humanoid (11%)	
Quantum computing (-5%)	

Share of company surveyed (%)

■ 2025 | 2018   ▨ Difference

IBM Watson

An Idea	With the Best of Intent	But Much to do still
IBM's bold attempt to revolutionize health care began in 2011. The day after Watson thoroughly defeated two human champions in the game of Jeopardy!, IBM announced a new career path for its AI quiz-show winner: It would become an AI doctor. IBM would take the breakthrough technology it showed off on television—mainly, the ability to understand natural language—and apply it to medicine.	The intent of IBM is well respected and shows a commitment to improve healthcare as a whole by providing a powerful "tool" that can scan, review, research and analyze millions of papers, documents, files, and thesis to what would have been a focus approached on the treatment of certain pathologies.	However, and according to research, the products that have emerged from IBM's Watson Health division turned out to be more like AI assistants that can perform certain routine tasks, versus brilliant IA doctors and physicians.

Encoding a human doctor's expertise in software turned out to be a very tricky proposition

Challenges

Many reasons challenge the full roll-out and implementation of Watson, including the fact that a bulk of the health records is "unstructured" information, such as doctor's notes and hospital discharge summaries. That narrative text accounts for about 80 percent of a typical patient's record—and it's a stew of jargon, shorthand, and subjective statements = unreadable by Watson's NLP processors

This has lead to situations such as that at "MD Anderson Cancer Center" who had partnered with IBM Watson to create an advisory tool for oncologists. The tool used natural-language processing (NLP) to summarize patients' electronic health records, then searched databases to provide treatment recommendations. Physicians tried out a prototype in the leukemia department, but MD Anderson canceled the project in 2016—after spending US $62 million on it

Several studies have compared Watson for Oncology's cancer treatment recommendations to those of hospital oncologists. The concordance percentage sample listed here indicates how often Watson's advice matched the experts' treatment plans*

Gachon University
Gil Medical Center, South
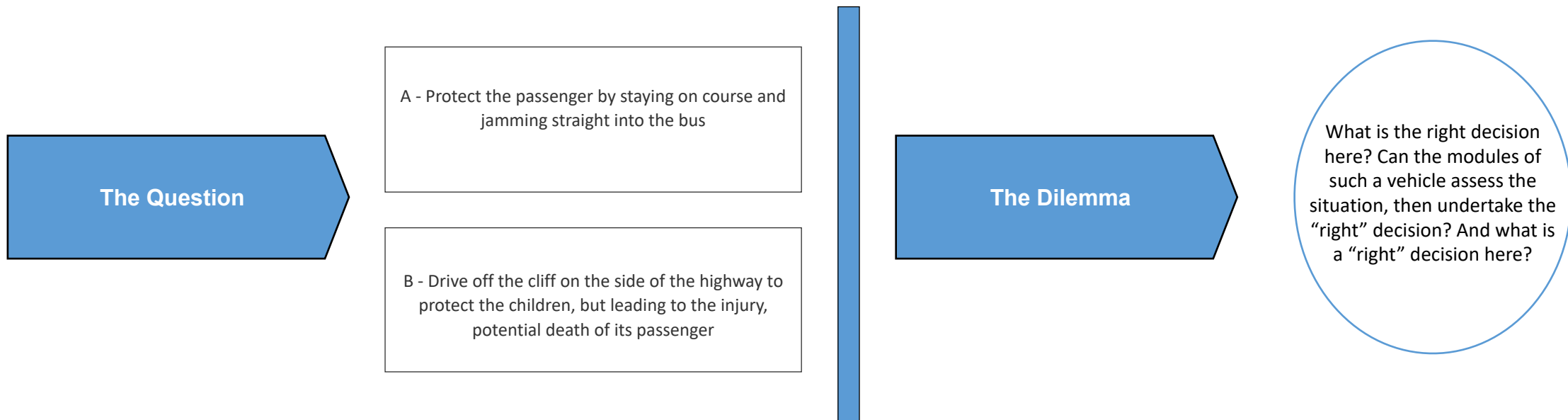Korea: 49% concordance

49
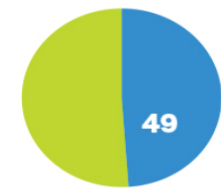
656 patients with
colon cancer

Autonomous Cars*

The autonomous car: it stops at the pedestrian crossings to give way to pedestrians. Another 'regular' car across the intersection, signals a left-hand turn; the autonomous car has the right of way so it takes the initiative and smoothly accelerates through the intersection...

Driving is a combination of continuous mental risk assessment, sensory awareness, and judgement all adapting to extremely variable surrounding conditions...

The autonomous car is cruising on a highway in its rightful lane at the set speed; there is an out of order bus with children on board on its path...

The Question

A - Protect the passenger by staying on course and jamming straight into the bus

B - Drive off the cliff on the side of the highway to protect the children, but leading to the injury, potential death of its passenger

The Dilemma

What is the right decision here? Can the modules of such a vehicle assess the situation, then undertake the "right" decision? And what is a "right" decision here?

Source: "The Driver in the Driverless Car" by Vivek Wadhwa and Alex Salkever

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The Internal Audit Function's Mandates: Reminders and References

Mission of Internal Audit	To enhance and protect organizational value by providing risk-based and objective assurance, advice, and insight

International Standards for the Professional Practice of Internal Auditing (Standards)

1200 – Proficiency and Due Professional Care

Engagements must be performed with proficiency and due professional care

Code of Ethics	… Demonstrates competence and due professional care … … Promotes organizational improvement …

1210 – Proficiency

Internal auditors must possess the knowledge, skills, and other competencies needed to perform their individual responsibilities. The internal audit activity collectively must possess or obtain the knowledge, skills, and other competencies needed to perform its responsibilities

2100 – Nature of Work

Core Principles for the Professional Practice of Internal Auditing	Competency:Internal auditors apply the knowledge, skills, and experience needed in the performance of internal audit services

The internal audit activity must evaluate and contribute to the improvement of the organization's governance, risk management, and control processes using a systematic, disciplined, and risk- based approach. Internal audit credibility and value are enhanced when auditors are proactive and their evaluations offer new insights and consider future impact
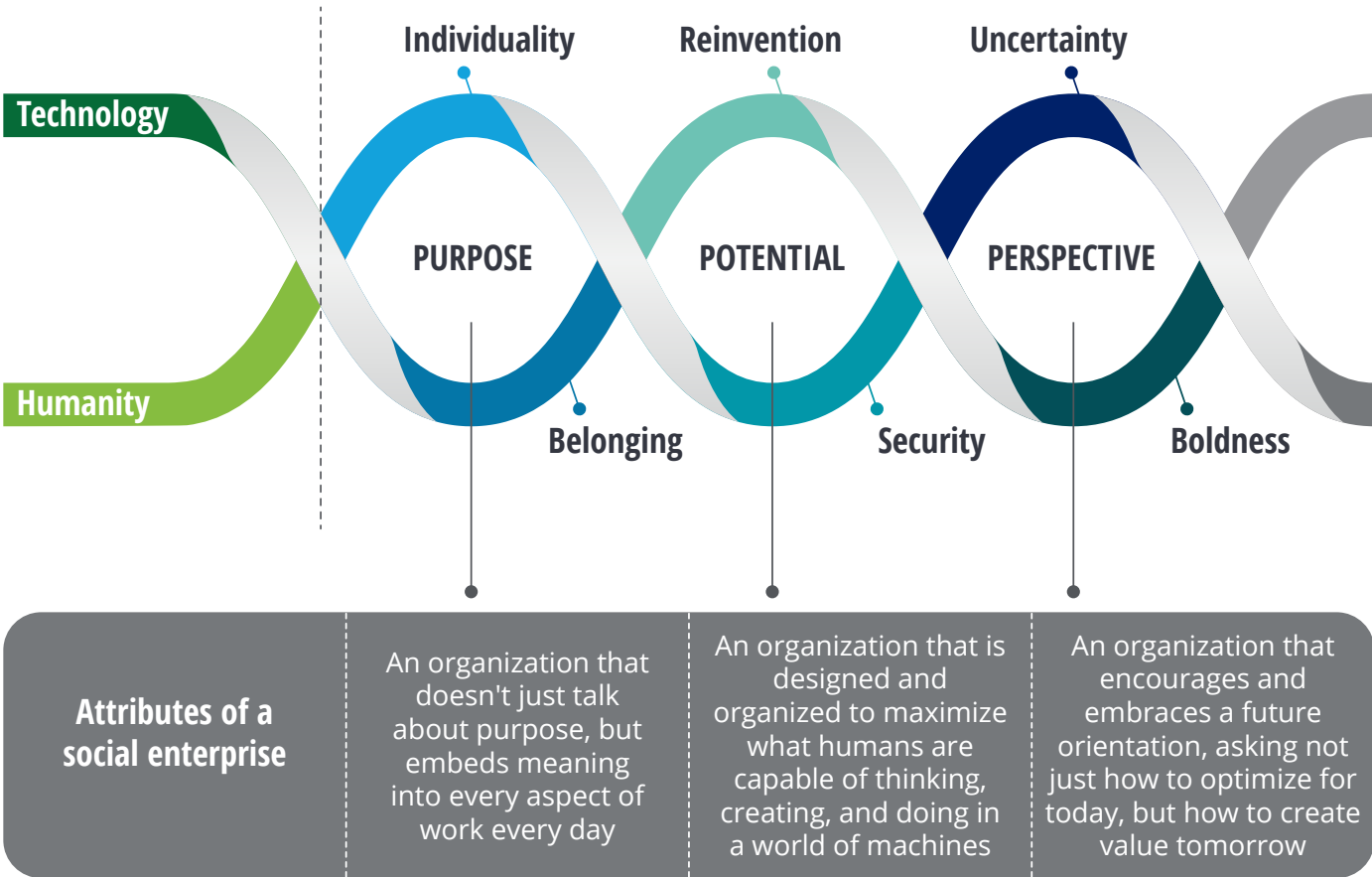
The Internal Audit Function's Mandate: The Social Enterprise Model*

In 2018, Deloitte introduced the concept of "Social Enterprise"

The "Social Enterprise" was defined as an organization whose mission combines revenue growth and profit making with the need to respect and support its environment and stakeholder network. This includes <u>listening to, investing in, and actively managing the trends that are shaping today's world</u>.

It is an organization that shoulders its responsibility to be a good citizen (both inside and outside the organization), serving as a role model for its peers and promoting a high degree of collaboration at every level of the organization
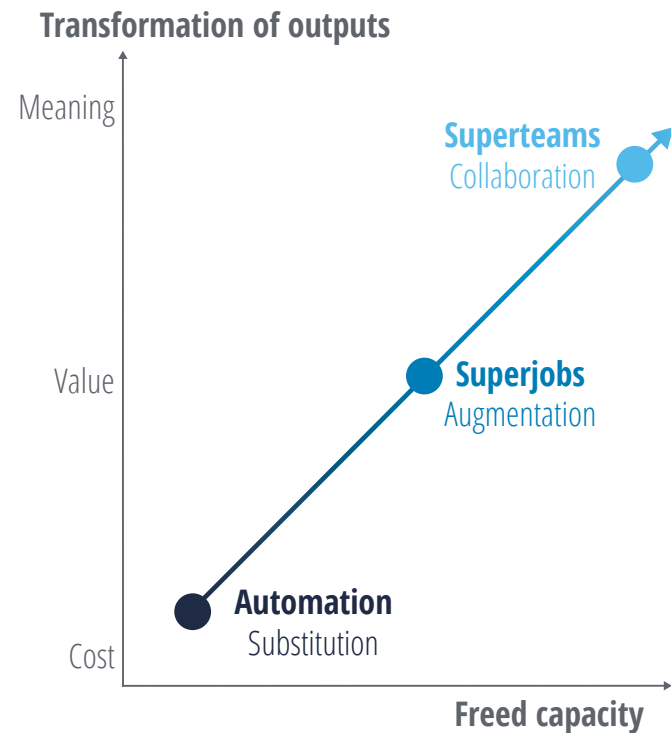
The social enterprise at work embodies a new set of attributes: purpose, potential, and perspective

Attributes of a social enterprise	An organization that doesn't just talk about purpose, but embeds meaning into every aspect of work every day	An organization that is designed and organized to maximize what humans are capable of thinking, creating, and doing in a world of machines	An organization that encourages and embraces a future orientation, asking not just how to optimize for today, but how to create value tomorrow

The Internal Audit Function's Ma... Way to Go

Transformation of outputs

Meaning

Superteams
Collaboration

Value

Superjobs
Augmentation

Cost

Automation
Substitution

Freed capacity

The Internal Audit Function has to be prudent with regards to recommendations on every aspect of improvement

it has to drive value where applicable and where tasks and jobs are better performed using RPAs, Bots, ML, AI enabled activities even if this means a revision of the headcount

But at the same time, this drive to embrace and embed technology has to follow a logic that goes beyond the bottom line

The reputational damage from mass lay-offs and workforce reduction can be detrimental to the company, and can lead to industrial action and potential regulator involvement and action, especially in times of crisis

The shift in mindset is here!

* Source: "2020 Deloitte Global Human Capital Trends", Deloitte

The Internal Audit Function's Mandates: Delivering Value

What does that mean for the organization, and how does that involve the Internal Audit Function?

- ★ Elaborate a clear vision of the future workforce
- ★ Identify the required skillsets, competencies and capabilities
- ★ Set the right resources in the optimal places via internal mobility/advancement or through external recruitment
- ★ Define value drivers
- ★ Communicate, and communicate again!

... Where AI is Integrated into the Organization's Components*

Domain	Steps toward integrating AI
Individuals	• Invest in building human capabilities that are paramount when working with AI on teams, including critical thinking and observation, cultural sensitivity, social intelligence, conflict resolution, and teamwork and collaboration. • Look for experiences that bring these capabilities to the forefront.
Leaders	• Learn to identify workers who have the right human capabilities to work effectively with AI. • Learn how to develop new workers with these capabilities. • Lead with a high degree of emotional intelligence and empathy.
Teams	• Reframe teams to include both humans and machines instead of relegating either to the sidelines. • Improve the ability to form and disband teams composed of local talent, virtual talent, and AI. • Align processes and performance management to adjust for AI's inclusion on the team.
Organizations	• Bring together the organization's agile or other team initiatives with its AI initiatives to undertake transformation efforts to pursue new and better outputs. This entails looking beyond cost to value as the goal and deliberately adopting augmentation and collaboration as the means. • Invest in experiential leadership development over an extended time frame to give leaders appropriate experiences to lead collaborative AI-human teams. • Develop a culture of doing the right thing to enhance workers' ability to anticipate AI's ethical impacts on the workplace and the organization's customers and reputation.
Ecosystems	• Identify potential partnerships with AI vendors and talent marketplaces and platforms to maintain access to both the technologies and the workforces needed to execute the organization's reimagined work.

* Source: "2020 Deloitte Global Human Capital Trends", Deloitte

Conclusion

"The only constant in life is change"

Heraclitus

6th Century BC

QUESTIONS?