



## Unlocking the value of Internal Audit

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# What is Internal Audit ?

“Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization’s operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance process.”

# What is a risk ?

A risk is the threat that an event, an action or the absence of action could impact:

- ▶ The achievement of objectives (of the group or individual management)
- ▶ The value of the group's assets (tangible and intangible),
- ▶ Compliance with rules and regulations

# What is Enterprise Risk management (ERM)?

An organization's competency to manage uncertainty, more effectively minimizing threats and maximizing opportunities.

ERM is characterized by systematic management practices to assess and monitor risks, and improve the way that risk is managed, supported and enabled by the appropriate risk management framework.

Enterprise risk management is a process, effected by an entity's board of directors, management and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risk to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objectives (COSO).

# What are Internal Controls ?

The dynamic, integrated processes, effected by an organization's board of directors (or equivalent), management and all other staff, that are designed to provide reasonable assurance regarding the achievement of objectives in the following general categories:

1. Effectiveness and efficiency of operations
2. Reliability of financial and management reporting
3. Compliance with applicable laws, regulations and internal policies.

# Business performance benefits from risk management

## Companies with more mature risk management are leveraging risk management to create a more robust and vital organization

- ▶ An Aon survey indicated 79% of organizations with advanced stages of risk management maturity were very or moderately successful in protecting and enhancing shareholder value
- ▶ In the same survey, 79% of organizations with advanced risk management maturity were very or moderately successful in facilitating change

## Companies with strong risk management attract increased investor funds and share price premiums

- ▶ An Ernst & Young survey indicated that 82% of investors will pay a premium for companies that demonstrate successful risk management
- ▶ In the same survey, 61% of investors will avoid investing if risk management is deemed insufficient

# Business performance benefits from risk management

## Companies with sound risk management were more effective in navigating the recent financial crisis

- ▶ A Marsh survey indicates that companies with strategic views of risk management are twice as likely as traditional companies to believe that their risk management systems helped them navigate the financial crisis

## Companies with strong risk management are likely to have better credit ratings

- ▶ S&P now rates companies on risk management as part of their credit ratings
- ▶ In Marsh's survey, 23% of respondents who indicated their company has made changes in risk management indicated a key driver behind those changes has been the increased focus by rating agencies like S&P

**If done well, risk management can create competitive advantage**

# Insights on Internal Audit

96% of companies believe strong risk management has a positive impact on their long-term earnings performance

94% of companies believe that their Internal Audit function has an important role in their overall risk management efforts

94% of companies have been asked to improve their risk coverage through Internal Audit

77% of companies have been asked to improve Internal Audit with the same or reduced cost/budget

*Source - Ernst & Young Risk Survey conducted in 2010 with Global Audit Committee Members, CEOs and CFOs*



# Insights on Internal Audit

44% of companies believe Internal Audit helps their organization achieve its business objectives

38% of organizations believe their Internal Audit function is consistently strong across all geographic locations

37% of organizations involve Internal Audit in key business decisions and strategy

32% of organizations believe their Internal Audit function attracts future leaders and high-potential talent from within the business

*Source - Ernst & Young Risk Survey conducted in 2010 with Global Audit Committee Members, CEOs and CFOs*

# Insights on Internal Audit



**74 % of organizations believe there is a need to improve their Internal Audit function**



**Of these organizations, 96% of companies believe they should make improvements within the next 24 months**



**77% of organizations consider co-sourcing viable, 66% consider outsourcing viable**



**51% of companies would consider outsourcing all or part of their IA organization for a cost savings of 20%**

Source - Ernst & Young Risk Survey conducted in 2010 with Global Audit Committee Members, CEOs and CFOs

# What are executives asking?

## Shareholder confidence

“Does my Internal Audit function understand their key stakeholder expectations?”



“Is my Internal Audit function contributing to key business objectives?”

## Cost competitiveness

“How can Internal Audit help to get better risk coverage for less cost?”



## Operational agility

“How do I know I am getting value from my Internal Audit function?”



Should my Internal Audit function be responsible to help add value and improve my business?”



“Does my Internal Audit function have the right skills in the right places?”



## Emerging markets/customer reach

# Questions You Should Ask About Your Company's IA Function

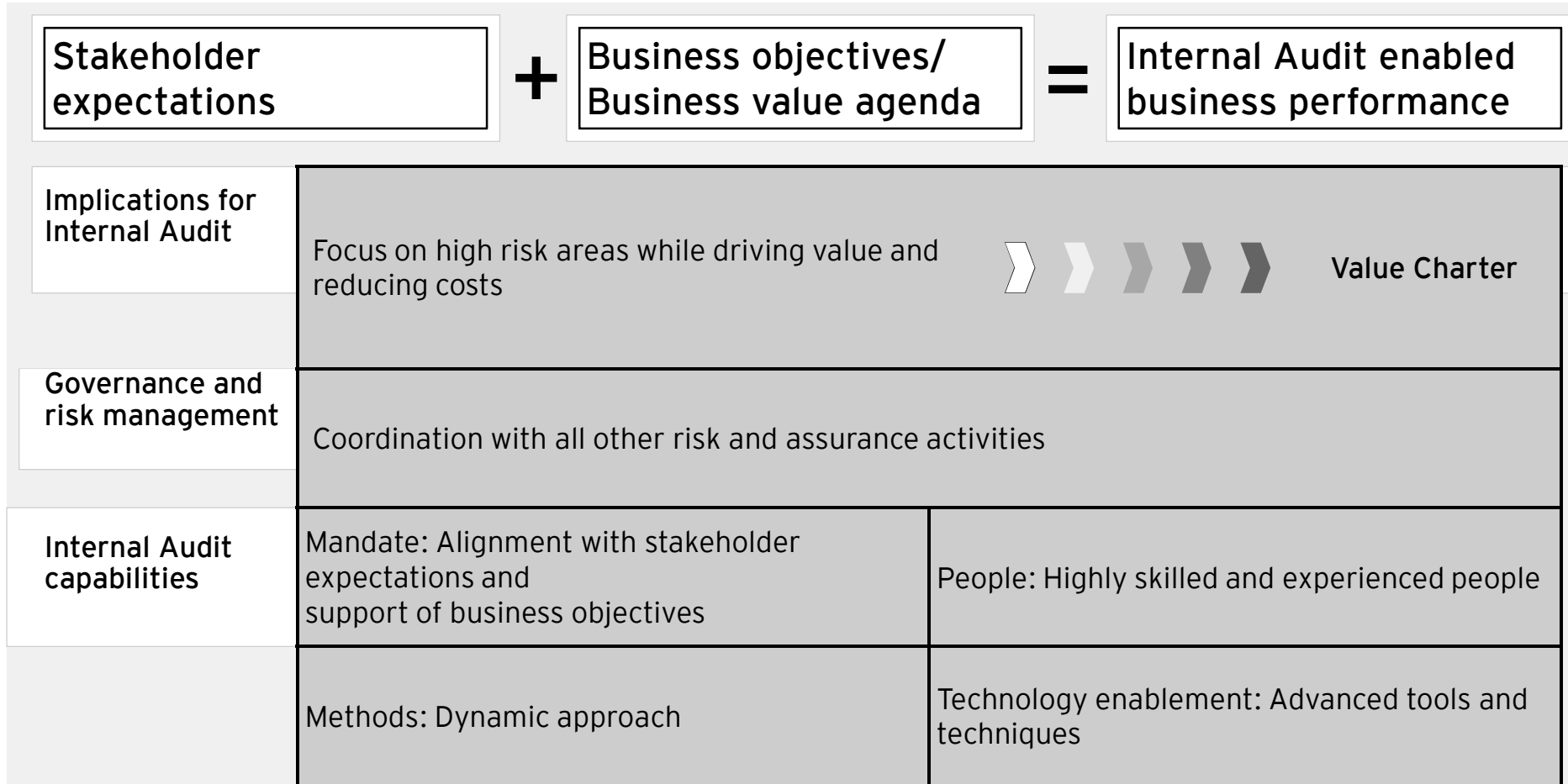
- ▶ What is the role of our IA function?
- ▶ How much of our company's risk is covered by our IA function?
- ▶ Does the function add value to the business?
- ▶ Do we have the right leadership for IA?
- ▶ Do we have the right IA people?
- ▶ How do we focus and motivate our IA professionals?
- ▶ How do we maintain consistent quality?

# Questions You Should Ask About Your Company's IA Function

- ▶ Does our IA function use the right tools to deliver value?
- ▶ How do we know if we are continuing to get what we want
- ▶ Are we investing enough?
- ▶ Do I know I have an effective Internal Audit function based on objective performance and cost benchmarks?
- ▶ What does Internal Audit do to help increase the competitiveness of my business?

# Linking business performance to Internal Audit

Internal Audit enables improvement to business performance

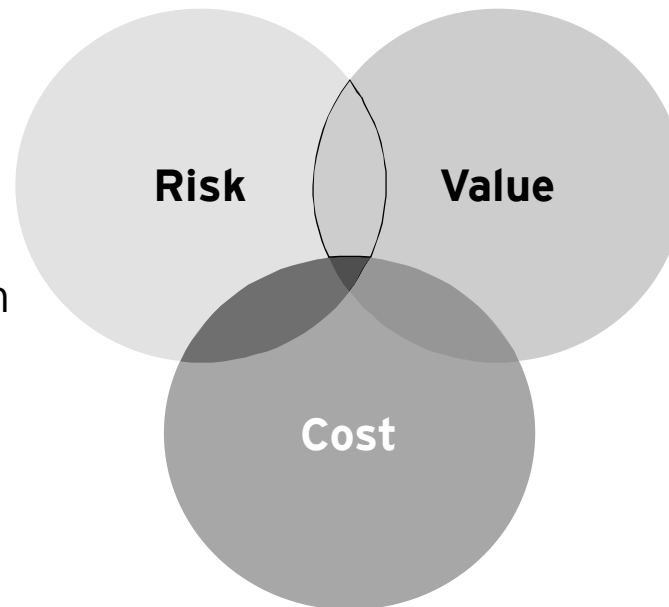


# Unlocking the value of Internal Audit

Aligning Internal Audit with business objectives

## Example risk objectives

- ▶ Improve risk assessment
- ▶ Enhance coverage of key and emerging risks
- ▶ Improve coordination with other risk functions
- ▶ Improve overall control awareness and control behavior



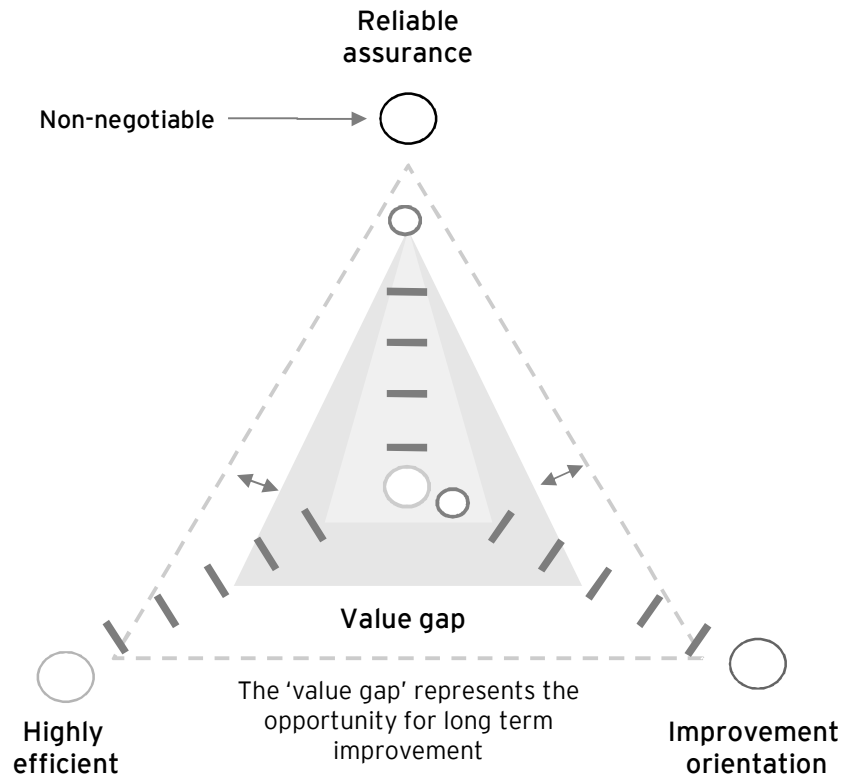
## Example value objectives

- ▶ Improve overall skills and personnel in the Internal Audit function
- ▶ Increase business performance capabilities
- ▶ Improve results on major change programs
- ▶ Advise on entering new markets
- ▶ Benchmark against peer organizations

## Example cost objectives

- ▶ Improve efficiency and effectiveness of the control environment
- ▶ Leverage technology to reduce Internal Audit costs
- ▶ Improve staffing flexibility to manage through peak/trough capacity demands

# What if internal audit was addressing stakeholder needs?

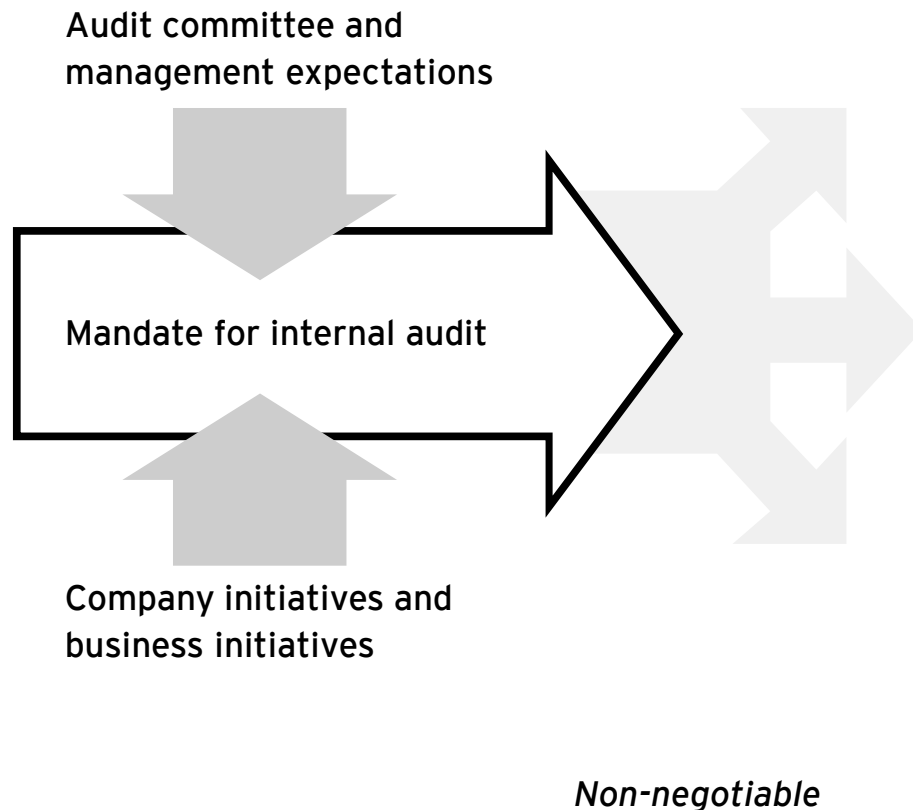


- ▶ A highly effective Internal Audit function has the following traits
  - ▶ Reliable assurance
    - ▶ Covering the entire spectrum of governance, risk management and internal control
    - ▶ Able to deliver a reliable EGRC appraisal in real time
  - ▶ Highly efficient
  - ▶ Quick to the answer
    - ▶ Fast and flexible
    - ▶ Rapid escalation, improvement
    - ▶ Cost effective
  - ▶ Improvement orientation
    - ▶ Facilitator of improved risk management and control across the firm
    - ▶ Rapid problem diagnosis
    - ▶ Setting the standards and stretching firm performance
    - ▶ Anticipate issues: fewer 'unknowns'
    - ▶ Known problems getting fixed - and if not, why not?
    - ▶ Sharing of best practices

**A highly effective audit function has a notable impact on the business as a result of delivering on the main characteristics illustrated.**



# What if internal audit was a valued business advisor?



## Strategic and Valued Advisor

Internal audit function serves as a subject matter specialist to business management around strategic initiatives, challenges and changes in the organization. The function has the people, knowledge and experiences to effectively provide this level of service.

## Business Insight

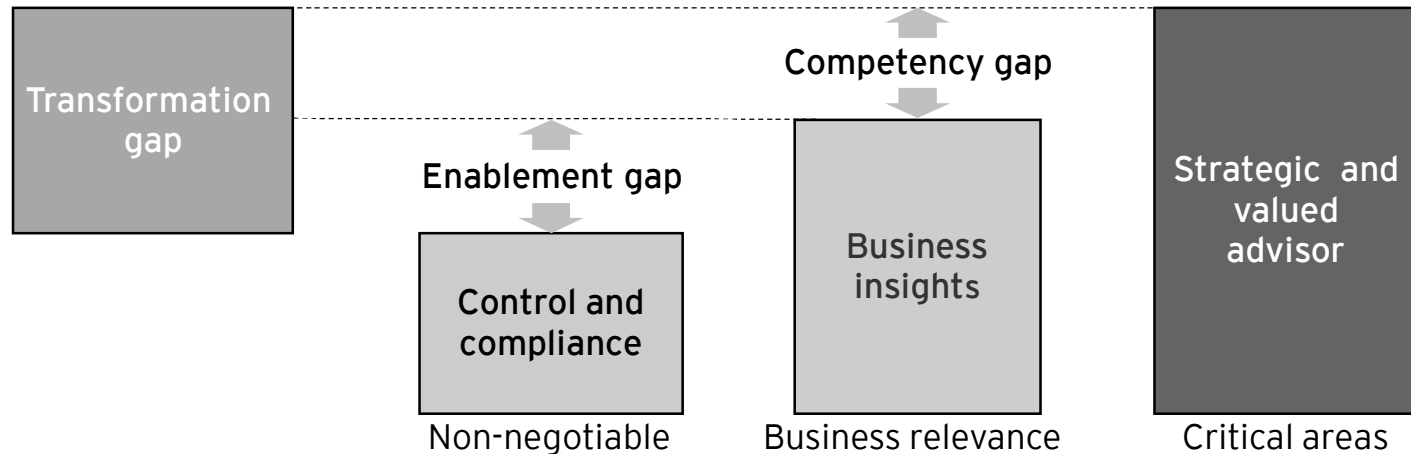
In addition to covering the "basics", the internal audit function is designed to provide high quality, relevant business insight as an integral part of its activities. Business insight is not a by-product, but an explicit outcome from the function's activities.

## Control and Compliance Monitoring Structure

Internal Audit function focused on evaluating the design and the effectiveness of internal controls in those areas outlined in their charter or mandate. Also includes focusing on compliance with key regulations and policies.

# What if the gaps were closed?

The transformation gap keeps many IA functions from becoming a strategic and valued advisor to executive management and their boards of directors. Targeting approaches that help fill the gap will allow for enhanced performance.



## Competency gap

- ▶ Rotational resource model
- ▶ Lack of scale to adequately staff certain areas
  - ▶ IT, international, treasury, taxes, supply chain
  - ▶ Fraud prevention and detection
- ▶ Audit activity = available resources
- ▶ Traditional role of internal audit function limits scope
- ▶ Alignment with strategic plan and initiatives to support
- ▶ Industry/competitive insight

## Enablement gap

- ▶ Traditional risk assessment and audit planning approach
- ▶ Not driven by business risk
- ▶ Heavy focus on auditable units and locations
- ▶ Limited use of data analysis and modeling
- ▶ Limited training and development
- ▶ Lack of effective prioritization
- ▶ Unwillingness to change
- ▶ Not focused on key business process improvements

**Filling in the gaps can help improve IA performance and client service.**

# Risk Assessment and Audit Planning

Are internal audit functions identifying all of the key risks that could have a significant impact on the business?

- ▶ The role of internal audit has never been more important. Internal audit must keep up with the increased scope of responsibilities and help to identify vulnerabilities to unknown or unacceptable levels of risks.
- ▶ Audit planning that is based on the results of strategy- based risk assessment allows internal audit to execute a plan that is focused on the most important business risks- strategic, operational, financial, and compliance - across the organization.

# Risk Assessment and Audit Planning

Does internal audit have the budget to cover all key business risk effectively?

- ▶ Many organizations do not believe that their internal audit functions have the necessary funding to help management effectively evaluate and monitor key business risks.
- ▶ The institute of Internal Auditors (IIA) fully supports a strong role for internal audit in managing organization-wide risk. IIA Standard 2010 states that internal audit should conduct an annual, or more frequent, risk assessment to serve as the basis for planning audit engagements.
- ▶ A formal, strategy-based, entity-level risk assessment by internal audit can help to advance significantly the organization's ability to understand its key business risks and, if done correctly, can become an integral part of management's risk assessment process.

# Risk Assessment and Audit Planning

Is internal audit effectively monitoring the top risks facing the organization?

The role of internal audit includes assisting management in identifying, prioritizing, reviewing, and monitoring risks. The first step is an effective risk assessment process.

**Questions that internal audit should ask to evaluate management's current risk assessment process include:**

- ▶ Does management currently conduct a risk assessment?
- ▶ Is the risk assessment process aligned with the organization's strategies?
- ▶ Does it address all key business risks across the organization?
- ▶ Are the appropriate stakeholders engaged in the process?
- ▶ What does management do with the results of the risk assessment?

# Risk Assessment and Audit Planning

Does internal audit have access to the right knowledge and technology tools to effectively identify, assess, and prioritize the key business risks of the organization?

- ▶ Some leading internal audit functions use industry-sector specific risk models and other external data to identify key business risks.
- ▶ Industry-sector risk models are available through various sources, including professional service providers.

# Risk Assessment and Audit Planning

Does internal audit have access to the right knowledge and technology tools to effectively identify, assess, and prioritize the key business risks of the organization? Continued

When evaluating the options, careful consideration should be given to understanding:

- ▶ Whether the risk data is truly industry or sector specific
- ▶ If the data highlights strategic and external risks
- ▶ How the data is gathered
- ▶ How often the data is updated.

# Risk Assessment and Audit Planning

Does internal audit have adequate resources and the right skill set to help management Address the top risk areas of the organization and execute the audit plan?

- ▶ The purpose of an audit plan is to provide detail on the audits to be performed, timing and assignment of teams with the requisite skill sets.
- ▶ The strategy-based, entity-level risk assessment provides the basis for developing an audit plan that is risk-focused and flexible enough to meet the needs of the organization's rapidly changing business environment.



# Risk Assessment and Audit Planning

Does internal audit have adequate resources and the right skill set to help management Address the top risk areas of the organization and execute the audit plan?

- ▶ Leading internal audit functions view the audit plan as a living, changing collection of risks and or control audits that are aligned with business activities and support management's effort to implement organizational strategies successfully.
- ▶ An audit plan that fails to keep pace with these changes allows significant business risks to emerge and not be addressed.

# Risk Assessment and Audit Planning

Does internal audit have adequate resources and the right skill sets to help management address the top risk areas of the organization and execute the audit plan? (continued)

**The key steps to developing a risk-focused audit plan are:**

- ▶ Mapping the key business risks to the auditable entities
- ▶ Developing an audit plan that addresses the auditable entities with the highest risk, without regard to available skill sets.
- ▶ Assigning resources with the skill sets necessary to participate on the audits

# Risk Assessment and Audit Planning

Does internal audit have adequate resources and the right skill sets to help management address the top risk areas of the organization and execute the audit plan? (continued)

- ▶ Validating the audit plan with management and the audit committee
- ▶ Revisiting the audit plan, as well as updating the risk assessment, as a result of the organization's changing business environment

# Risk Assessment and Audit Planning

## Critical Success Factors for an Executive Risk Assessment and Audit Plan Process

- ▶ **Audit Committee and Executive Management Sponsorship** - the importance of sponsorship from the top cannot be overemphasized. Many hurdles can be overcome with the proper level of support.
- ▶ **Stakeholder Accessibility and Participation** - Access to and participation by, all stakeholders is crucial to effectively identifying and assessing the organization's key business risks and to validating the audit plan.
- ▶ **Necessary Skills Sets** - The internal auditors who are responsible for preparing and conducting the assessment must possess the necessary skill-sets to help management identify and assess key business risks.

# Risk Assessment and Audit Planning

Critical Success Factor for an Effective Risk Assessment and Audit Plan Process, Continued.

- ▶ **Maintaining Objectivity** - IIA Standards 1120 and 1130 advocate that internal auditors remain objective in their work, both in appearance and in fact. When working closely with leadership across the organization, the internal audit team must maintain a degree of healthy skepticism, even as the audit team strives to develop a rapport with the stakeholders during meetings, interviews and workshops.

# Risk Assessment and Audit Planning

Critical Success Factor for an Effective Risk Assessment and Audit Plan Process, Continued.

- ▶ **Knowledge** - Strategic business risks are as dynamic as the business they influence. Having access to relevant, timely, and sector-specific risk data can mean the difference between an organization successfully managing key business risks on a timely basis and it being exposed to unwanted business or market risks.
- ▶ **Technology** - There are a number of technology platforms that enable risk assessments, audit planning, scheduling and audit execution.

# Risk Assessment and Audit Planning

## Management Consideration

- ▶ Today's internal audit functions face many challenges in providing increased value to their organizations and to execute an audit plan that aligns with the business and focus on key business risks. Questions to help internal audit address these challenges include:
- ▶ Have all of the key business risks that have a significant impact on the organization been identified?

# Risk Assessment and Audit Planning

## Management Consideration, Continued

- ▶ What processes, knowledge sources, and technologies will facilitate the assessment and prioritization of key business risks and the development of the risk-based audit plan?
- ▶ Does the internal audit plan cover all the key business risks facing the organization?
- ▶ Does internal audit have the necessary resources and skill sets to help management address the top risks and execute the audit plan?



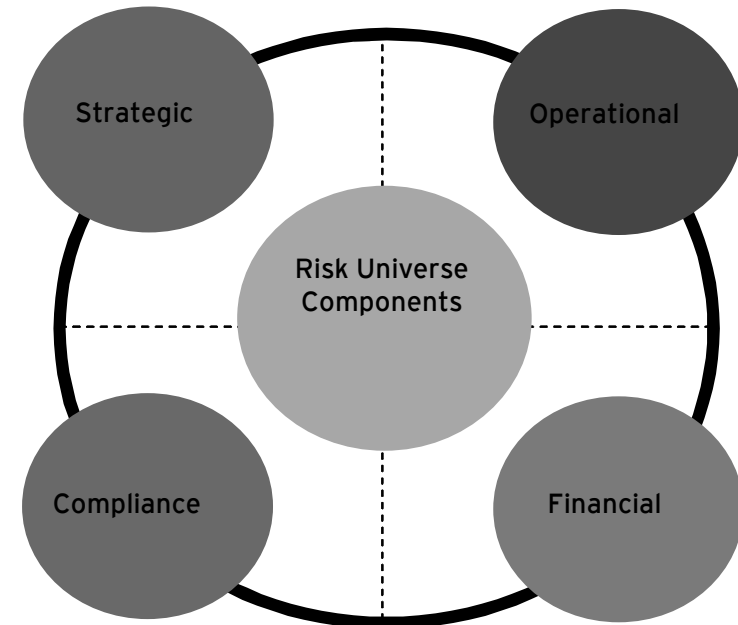
# Internal Audit Value Case Study - Internal Audit Department Establishment

## The business objective(s):

- ▶ Subsidiary's parent mandated the establishment of an internal audit function
- ▶ Establish a solid risk framework for which to execute and report to executive management

## The role of Internal Audit:

- ▶ Performed an entity wide risk assessment to establish a baseline of the company's risk universe and a risk tolerance based on management's criteria, communication and reporting protocols.
- ▶ Worked closely with management to verify that the internal control environment was not compromised due to significant employee turnover and decreasing profits due to the economy.
- ▶ Established an internal audit function including a cross functional team (Risk, ITRA and PI) to assist the Company in executing the Internal Audit plan and other key initiatives (e.g., Shared Service Center)



## The results (benefits/impacts):

### Value added

- |  |   |
|--|---|
| 1. Developed risk tolerance and internal audit risk rating to establish common materiality and expectations  | ✓ |
| 2. Due to knowledge that Internal audit had of the Company, PI is currently assisting management of Parent and Subsidiaries management in building multiple shared service centers globally. | ✓ |
| 3. Established a solid framework to help management to strategically invest in a more robust economic environment.   | ✓ |

## The Bottom Line ...

- Established the ground work for the internal audit department.
- Assistance was provided to the internal controls manager in establishing the internal controls framework.
- During the risk assessment Internal audit identified a number of strategic areas management must address to establish a successful strategy.

# Internal Audit Value Case Study - Internal Audit Transformation

## The business objective(s):

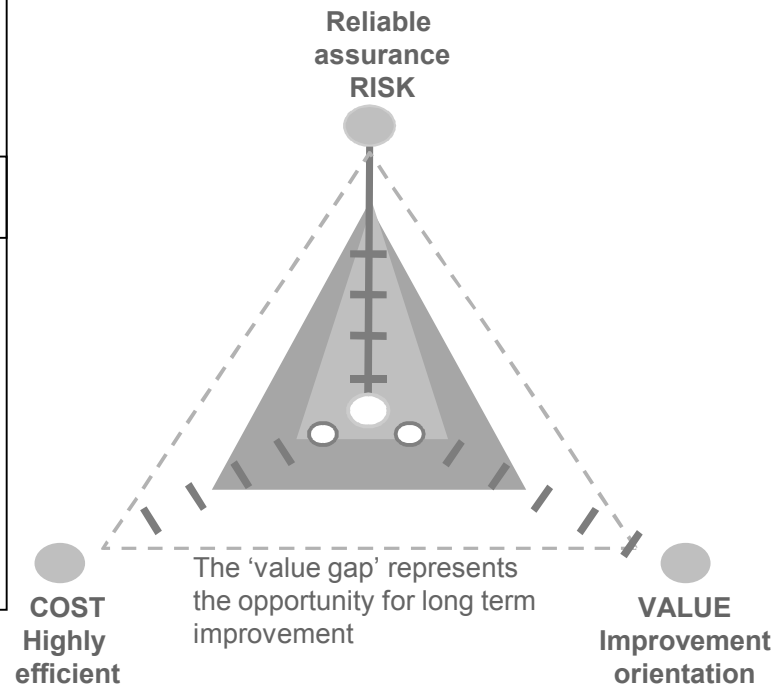
- ▶ Standardize and harmonize processes across the IA function.
- ▶ Centralize and optimize processing activities.
- ▶ Leverage technology and process best practices.

## The role of Internal Audit:

- ▶ The team was comprised of risk, IT and process improvement resources to assess and identify opportunities for improvement to transform the Internal Audit (IA) and other risk functions.
- ▶ The team performed an assessment of the IA team structure, roles, responsibilities and job descriptions.
- ▶ The team also interviewed stakeholders to determine the effectiveness of the internal audit and other risk functions for process improvements, effectiveness and efficiencies.

## The results (benefits/impacts):

	Value added
1. Internal audit revised its existing team structure to gain efficiency and better align itself with other risk functions.	✓
2. Internal audit adopted a more consistent approach, methodology, documentation and reporting standards to allow for greater synergies within Internal Audit as well as the other risk functions.	✓
3. Internal audit reduced and in some cases, eliminated low risk audit activities allowing the department to focus on higher risk areas.	✓



## The Bottom Line ...

The company was able to eliminate inefficient processes that resulted in a reduction in headcount and cost savings estimated at \$6-\$8 million.

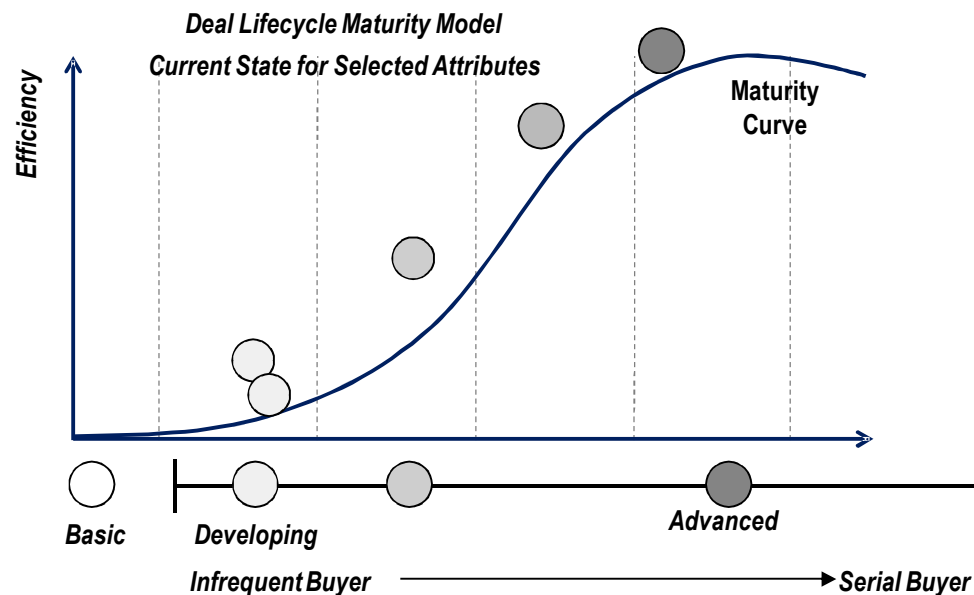
# Internal Audit value case study - M&A process assessment

## The business objective(s):

- ▶ As M&A activity at the Company had gained momentum over the past years, management identified processes needing significant improvement and greater consistency across the Company.
- ▶ Define a structured framework for managing the deal lifecycle
- ▶ Enhance in-house expertise in all areas of M&A to enhance deal value and mitigate M&A risks
- ▶ Provide a M&A Playbook for facilitating the deal lifecycle

## The role of Internal Audit:

- ▶ Internal audit played a lead role in benchmarking current processes against leading industry practices for mergers and acquisitions
- ▶ Internal Audit identified improvement opportunities for key processes and provided a roadmap for reaching an optimal M&A process maturity



## The results (benefits/impacts):

	Value added
1. IA served as a knowledge source to provide insights on leading M&A practices.	✓
2. IA lead the development of maturity profile of Company's current state processes and desired future state.	✓
3. IA partnered with the business to identify prioritized improvement opportunities and develop a roadmap of action items.	✓

## The Bottom Line ...

Internal audit co-developed and gained executive management consensus for a future state vision aimed at ensuring the right transaction opportunities are targeted and properly negotiated, and that value creation is optimized.

# Internal Audit value case study

## Major construction / renovation project

### The business objective(s):

- ▶ Successfully perform new construction, renovation, and maintenance of current facilities throughout the U.S. in conjunction with \$2.1 billion capital program
- ▶ Achieve quality, on-time and on-budget construction projects
- ▶ Achieve enhanced compliance, process improvement, risk mitigation, and consistency in operating practices among financial and operational aspects of construction projects

### The role of Internal Audit:

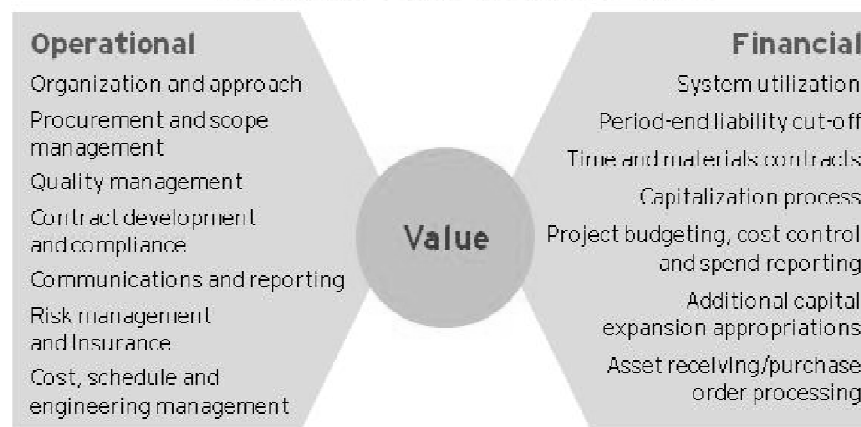
- ▶ Internal audit leveraged subject matter resources with construction & real estate advisory experience in conjunction with Risk professionals, and evaluated financial and operational aspects of construction projects at selected high risk locations
- ▶ Through interviews of Company personnel, review of project organization, leadership and management, the team performed an evaluation of operational processes and controls inherent to construction projects

### The results (benefits/impacts):

Value added

- |  |   |
|--|---|
| 1. Subject matter resources helped reduce the risk of operational breakdown by evaluating on-going construction project risks (e.g. cost overruns, schedule delays, loss or productivity, quality issues) and identifying process improvement opportunities leveraging deep industry specific knowledge. | ✓ |
| 2. IA identified process improvements that lead to a reduction in financial risks such as improper accounting, misappropriation of assets, lack of proper payment authority and excess spending.   | ✓ |

### Capital projects internal audit - providing value from two sides



### The Bottom Line ...

Internal Audit evaluated \$6 million of construction change order costs and recovered \$2 million in non-allowable charges.

In addition, Internal Audit identified significant financial control weaknesses, which, if not identified, could have potentially cost the Company \$15 - \$20 million per year.

# Internal Audit Value Case Study - ERP System Implementation

## The business objective(s):

- ▶ To implement an ERP system in an effort to streamline the close process and create a unified chart of accounts for the company. The implementation would allow for improved reporting, improved accuracy of financials, and increase operational efficiency of the close process.

## The role of Internal Audit:

- ▶ Internal Audit leveraged Risk and ITRA professionals (with financial close, internal control and system implementation experience) to evaluate the implementation strategy and execution, the process design, and the manual and application control design for the project.
- ▶ Management also requested that Internal Audit provide a recommendation on when the system would be functional to go-live.

The results (benefits/impacts):	Value added
1. Internal Audit helped reduce the risk of operational and financial breakdown by: <ul style="list-style-type: none"> <li>- evaluating on-going implementation project risks: schedule delays, testing results, mapping issues etc.</li> <li>- identifying process improvement opportunities and controls gaps leveraging on process and information technology knowledge.</li> </ul>	✓
2. Internal Audit delayed the go-live date of the system several times until the system was properly functional.	✓

## The Bottom Line ...

Internal Audit aided the company in successfully implementing a new ERP system by providing recommendations on improving the process, adding additional controls, and delaying the go-live date of the new system until all testing was completed without issue. The system went live with zero defects.

# Options to Transform IA - Benefits and Challenges

	Outsourcing	Co-sourcing	In-house
<b>Benefits</b>	<ul style="list-style-type: none"> <li>➤ Fastest route to desired state</li> <li>➤ Quickly enhances credibility of function</li> <li>➤ Least expensive option-investment in methodology, technology, training, recruitment/retention are borne by third party</li> <li>➤ Ability easily expand /contract spend</li> <li>➤ Only paying for productive time</li> <li>➤ Third party deals with personnel related issues</li> </ul>	<ul style="list-style-type: none"> <li>➤ Higher productivity while expanding risk coverage</li> <li>➤ Ability to leverage third part's investment in tools, methodology etc.</li> <li>➤ Portion of function is variable cost</li> <li>➤ Raises the bar for productivity/quality</li> <li>➤ Maintain organizational knowledge</li> <li>➤ Highly flexible</li> <li>➤ Consideration given to Hiring certain in-house resources to help with the transition process</li> <li>➤ Potential talent pipeline for organization</li> </ul>	<ul style="list-style-type: none"> <li>➤ Least disruptive to employees and organization</li> <li>➤ Maximize organization knowledge/relationships</li> <li>➤ Historical knowledge of IA is maintained</li> <li>➤ Potential talent pipeline for organization</li> </ul>
<b>Challenges</b>	<ul style="list-style-type: none"> <li>➤ Change management considerations</li> <li>➤ Cultural change for the organization</li> <li>➤ Potential loss of organizational knowledge</li> </ul>	<ul style="list-style-type: none"> <li>➤ Cultural integration of different audit teams</li> <li>➤ Existing personnel development challenges</li> <li>➤ HR process around identifying employees to retain/terminate</li> </ul>	<ul style="list-style-type: none"> <li>➤ Highest cost model</li> <li>➤ Longer time frame to effect desired transformation</li> <li>➤ Increased and continuous investment in methodology, people and tools</li> <li>➤ Inflexible staffing model</li> <li>➤ Existing performance issues/upward mobility challenges</li> </ul>

... Questions?

