Internal Audit at a Crossroads: How will you get ready?*

Ilvija Grūba Consulting PricewaterhouseCoopers SIA December 2009



Agenda

Internal Audit at a Crossroads Summary of Research Results Some keys to improvement "In the next five years – your profession will be revolutionized... A compliance based approach (to internal audit) is something of the past."

Mervyn King July 9, 2007 IIA International Conference – Amsterdam, NL

Agenda

Internal Audit at a Crossroads Summary of Research Results Some keys to improvement

Transforming your focus on risks

As companies move toward risk management, Internal Audit must also evolve – or risk a diminished value proposition

20th Century Internal Audit Model

Controls assurance based on cyclical or routine audit plans



The Common Internal Audit Model in 2007

Controls assurance based on a riskbased internal audit plan



The Risk-Centric Internal Audit Model

Risk and control assurance based on the effectiveness of risk and control processes implemented by management

If the view (among stakeholders) grows that all Internal Audit does is test controls, then resource levels will have to come down. Chief Audit Executive, Financial Services Industry

Traditional internal auditing will probably diminish in value if the organization moves towards formal risk management. Senior Executive, Rating Agency

"Globally, almost 80% of internal auditors expect audit coverage related to risk management will increase over the next three years."

"A Global Summary of the Common Body of Knowledge," © 2007, The Institute of Internal Auditors Research Foundation

Views on the Internal Audit Activity

Type: Executive Summary Report

Date: 9/23/2009

Total number of responses: 615



1: What should be the main role of internal auditing in your organization?

(Respondents could only choose a single response)

(Respondents could only choose a single response)				
Response	Chart	Frequency	Count	
Using a risk-based approach, ensure controls are adequate to mitigate a variety of different types of risks.			40.7%	249
As a value-added function, advise and consult management and the board on governance processes, the effectiveness and efficiency of the organization, and whether organizational goals and objectives are being met.			51.3%	314
Ensure compliance with laws and regulations is met.			2.5%	15
Ensure financial controls are effective.			1.6%	10
Other; specified below.			3.9%	24
Not Answered				3
		Valid F	lesponses	612
		Total F	lesponses	615

2: How often should your audit committee communicate with the chief audit executive (including both formal and informal communication)?

(Respondents could only choose a single response)

Response	Chart		Frequency	Count
weekly			7.3%	45
monthly			40.0%	245
quarterly			38.2%	234
semi-annually			4.2%	26
annually			1.1%	7
We do not meet with the chief audit executive.			2.4%	15
Other; specified below:			6.7%	41
Not Answered				2
		Valid R	lesponses	613
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Transforming your focus on risks

Stakeholders' perspectives on the future of Internal Audit

The focus of internal audit should evolve and align with emerging/ changing risks.

Strategic & Business 60%

Operational 20%

Compliance 5%

Financial 15%

Corporate Strategy

Lack of effective measurement processes to determine whether strategies are achieving their long term objectives.

Inadequate consideration of impacts relating to risks and of risk mitigation activities during strategic planning and budgeting.

Industry

Market/environmental forces that affect an entire industry – current economic crisis, natural disasters

Competitors – new entrants, new regulations, new capabilities

Customer Focus

Failure to anticipate changing consumer needs, which may lead to ineffective product development / loss of market share

Lack of consumer measurement or satisfaction process to assess whether company is meeting customer expectations.

Reputation

Major product failure, unethical behavior, or poor quality of service

Transformed vs. traditional risk assessment approach

Identify Shareholder Value **Creating Activities Understanding Enterprise** Risks (Strategic, Financial, Operations, Compliance) **Evaluate Impact to Shareholder** Value Audit plan **Evaluate Impact of** Risks within Audit Universe Identify Risks (Financial Operations, Compliance)

Define Audit Universe (e.g., geography, business unit, etc.)

Shareholder Value Based Approach

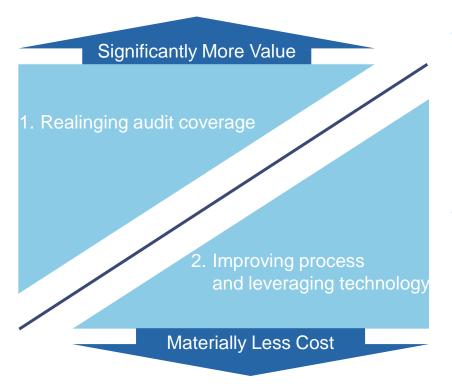
"Top-down" approach where coverage is driven by issues that directly impact shareholder value, with clear and explicit linkage to strategic issues of the organization.

Traditional Approach
Traditional "bottom-up"
approach based on
stakeholder interviews and
analysis. Focus is on
coverage of identified risk
areas, geography and
business operations.

Internal Audit at a Crossroads

Stakeholders' perspectives on the future of Internal Audit

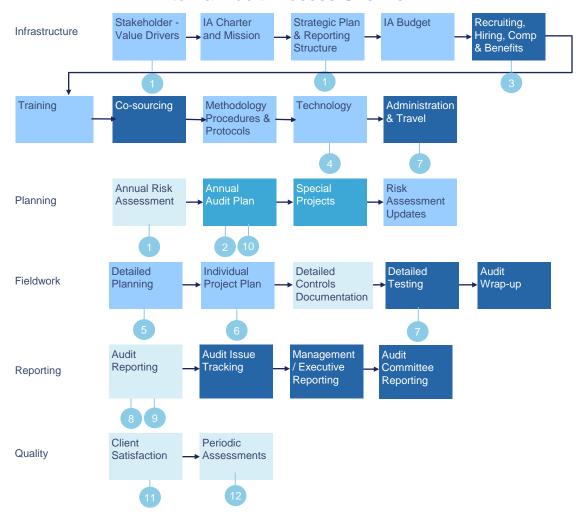
Internal audit must streamline its processes and leverage technology to reduce costs and enhance the quality of its services.



- Technology to improve the efficiency of the audit process
 - Automate issue tracking
 - Streamlined reporting
 - Knowledge management and leading practices
 - Storage and retrieval of work products
- Technology to execute audits
 - Data retrieval software to automate testing
 - Increase audit coverage
 - Focus on anomalies
 - Data mining/analysis software for predictive analysis and modeling
 - Continuous monitoring

The transformed approach enhances efficiencies and lowers cost

Internal Audit Process Overview



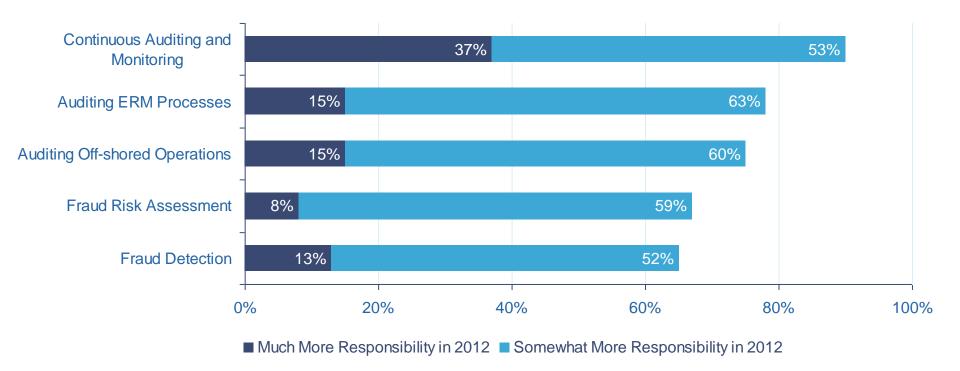


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Survey results: Changes in Internal Audit roles and responsibilities

Areas of Increasing Responsibility by 2012



Fraud is on the rise again. But I am not sure that Internal Audit is prepared. No one is readily able to educate, find and resolve fraud issues.

Chief Audit Executive, Transportation Industry

Changes in Internal Audit's Role

4 Continuous auditing or monitoring

Areas of greatest projected increases in internal audit's responsibility include:

1. Continuous auditing or monitoring	95%
2. Auditing the ERM process	77%
3. Auditing outsourced or off-shored operations	75%
4. Fraud detection	66%
5. Fraud risk assessments	66%
6. Auditing executive comp and disclosures	65%
7. Auditing operational efficiency/effectiveness	64%

Survey results: Skill sets that will be more important by 2012

1.	Data mining & analysis	89%
2.	Risk assessment	76%
3.	Information technology	72%
4.	Risk management	70%
5.	Fraud detection	69%

The ability to conduct data analysis is essential. *Chief Audit Executive, Healthcare Industry*

Integrating technology and the finance skill set is becoming more and more important. *Chief Audit Executive, Technology Industry*

Sarbanes-Oxley has developed an Internal Audit culture of staff believing they could "stop thinking." Internal Audit needs to get back to having business conversations, be better prepared, and have an understanding of what is going on in the business. Chief Audit Executive, Consumer Products Industry

Survey respondents indicating the skill set will be "far more important" or "somewhat more important" than today.

Key trends PwC believes will reshape Internal Audit by 2012

- Changes in risk management
- Changes in Internal Audit roles
- Organizational and talent management trends
- Globalization
- Technology

Through analysis of both survey and interview data, PricewaterhouseCoopers believes these broad trends will drive change in Internal Auditing over the next 5 years.

Technology

- Impact of technology over the next five years was a recurring theme from the research
- Participants anticipate major changes in what they audit and how they audit and the skills that will be needed
- 100% expect use of technology to increase
- IT capabilities expected to grow the most in importance:

- Privacy-related risks	60%
- Off-shored technology operations	60%
- Automated controls	60%
- ERP systems	53%
- Network security	51%
- Data warehouse controls	50%

8: Which three words should best describe a high-performing audit activity: (Respondents were allowed to choose multiple responses)

Response	Chart			Frequency	Count
Integrity				41.8%	257
Ethical				19.3%	119
Assurance				27.8%	171
Efficiency				16.6%	102
Accountability				8.1%	50
Transparency				7.6%	47
Insight				4.6%	28
Objectivity				58.5%	360
Reliability				15.4%	95
Recognized				3.1%	19
Trusted				12.7%	78
Valued				22.3%	137
Independence				60.3%	371
Other(s); specified below.				1.8%	11
			Valid R	lesponses	615
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Strategy

Organization

Peopl e

Proce ss

Technol ogy

Refine Current Strategies

- Understand stakeholder needs
- Align internal audit strategy to broader needs of stakeholders and the enterprise through a comprehensive risk assessment (combining strategic, operations, financial reporting, compliance risks)

Talent Management

- Use of internal and external resources
- Consider implementing a rotational staffing model to attract and retain talent

Capabilities Assessment

- Inventory existing skills
- Conduct gap analysis
- Determine adequacy of resources to respond to all key risks

Audit Cycle Improvements

- Align internal audit with organization's strategic objectives and implement performance metrics
- Reduce audit cycle time by conducting more targeted audits
- Increase value derived from focus on higher-risk areas
- Improve communication to stakeholders through concise, impactful reports

Optimization of Technology

- Reduce the labor content of audits by increasing the effectiveness of lowerrisk audits
- Provide real time monitoring of significant risks
- Explore areas where technology can streamline or standardize a process
- Test entire data populations electronically

Ten Imperatives for Success in Next Five Years:

- 1. Strive continuously for appropriate alignment and stature of internal audit within your company
- 2. Develop and regularly update a formal strategic plan
- 3. Communicate continuously with key stakeholders
- 4. Ensure alignment of internal audit human resources strategies with enterprise and stakeholder needs
- 5. Maintain a continuous focus on enterprise risks and migrate toward a "risk-centric" value proposition

Ten Imperatives for Success in Next Five Years:

- 6. Enhance IT audit skills and capabilities and continuously strive for an integrated approach to IT audit coverage
- 7. Identify and implement technology solutions to enhance internal audit's efficiency and effectiveness
- 8. Leverage the collective knowledge and expertise of internal audit through a formal knowledge management strategy
- Commit to continuous quality assurance and improvement
- 10. Link performance measures to strategic goals

Thank you!

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