

In Brief*

Internal Audit 2.0

Transforming the Internal Audit department from being focused on compliance and financial reporting to managing strategic risks will help bring about efficiencies and alignment with the overall business.

Challenges facing organizations in Alberta

- While risk management functions are facing cutbacks due to the downturn, the need to manage risk is more important than ever.
- The oil and gas industry is under significant economic pressure and business leaders are looking at ways to be more efficient.
- Large contracts, construction projects, environmental concerns, and a new royalty regime—these are the strategic areas that need to be assessed with an eye to the future.
- The downturn means companies could be at significantly higher risk for fraud. In the past, Internal Audit has reacted to fraud rather than being proactive and looking at areas where it is likely to occur and taking action before it happens.

The current downturn, and an increasingly complex business environment, have alerted many to how critically important risk management is for business success. The impact of failing to assess risk is staggering if one considers researchers have found that strategic and business issues are the most common means by which organizational value is eroded. In fact, it is responsible for 60% of lost value—with operational issues driving another 20% of the loss. But with organizations facing cost-constraints, most are not in a position to make additional investments in risk management. And yet there is an often overlooked solution: transforming the Internal Audit department into a component of strategic risk management.

Unfortunately, not all Internal Audit departments are currently equipped to take on this new role and its related challenges. Since 2002/03, most publicly traded companies and government organizations have spent the bulk of their Internal Audit effort on compliance and assessing controls specific to the financial reporting

process. With 70% of their time spent on those issues, few have had the resources and experience to turn their attention to more operational and strategic areas and risks such as assessing whether potential acquisitions are in alignment with their organization's strategic goals and focus. For example, many organizations are struggling today because they did not undertake appropriate credit risk management measures to ensure they were not over leveraged and that their investment decisions were sound.

Organizations can no longer afford to limit Internal Audit to compliance and financial reporting. As a result there are growing expectations that Internal Audit take on activities that add value to the overall business.

A minority of organizations are making changes to their business models in order to adapt to the new economic reality. But for all organizations, this is an opportune time to transform Internal Audit departments, shifting them to play a greater role in operational, strategic areas and risk management.

The risks of not transforming the IA department

- A failure to achieve the maximum value from the IA department in a new competitive environment where every department in the organization needs to contribute.
- Inefficiencies and possible cost savings that remain unidentified, jeopardizing your organization's competitive advantage.
- Undetected operational and strategic risks and opportunities that could help the turnaround.

How do you make the transformation happen?

- Analyze the IA Department's annual plan based on a solid understanding of the organization's strategic initiatives, stakeholder expectations and business risks.
- Gather data to assess current state of internal audit coverage.
- Link the organization's strategic objectives and shareholder value drivers to internal audit's scope.
- Consider how previously unaudited areas might be audited, then align auditable risks to the audit plan.
- Create a value map that highlights every important value objective and link those objectives to specific processes that are linked to the audit plan.
- Consider areas for cost containment reviews.
- Based on the updated audit plan, consider transformational ideas to reduce cost within internal audit.
- Eliminate routine, low-value audits.
- Identify inefficient processes within IA.
- Ensure you have the right skill sets in the Internal Audit department for its new strategic role because many employees in audit departments today lack operational or strategic skill sets.
- Use the right technology to reduce IA costs and improve its capabilities and efficiencies.
- Develop implementation plans for transformational concepts as well as anticipated process efficiencies.

Benefits

- An IA department that can: Identify strategic risks, pitfalls and opportunities that management might not see because they are too close to the issue. The transformed IA department offers a fresh perspective and an independent lens.
- Add value across the organization and improve efficiencies and reduce costs in multiple areas. For example, the IA can conduct procurement reviews with a strategic perspective and ensure prices of high-value contracts are in line with current global prices, potentially resulting in measurable cost savings.
- An Internal Audit department that is fully aligned with the organization's strategy and stakeholder expectations.
- An Internal Audit department that is perceived by others within the organization as trusted business advisors rather than as policemen.

Value builders	PwC perspective
A value map to guide the transformation	<p>The transformation requires a holistic approach.</p> <p>“We have significant experience in making sure that the initial risk assessment or the transformation process is focused on the right value map for the organization and is in alignment with stakeholder expectations and business strategy,” says Matthew Wetmore, Partner, Internal Audit Services, PwC.</p>
The skill sets to go the distance	<p>PwC can help train or collaborate with the Internal Audit department to upgrade the skill sets of the IA team.</p> <p>“We, as a multidisciplinary team, have people with a variety of different skill sets and can bring them to the client to address some of the strategic and operational areas and send them down the right path,” says Dave Thompson, Partner, Internal Audit Services.</p>
The ability to benchmark	<p>Benchmarking is important because it allows you to form realistic expectations about what you can achieve. This is not an overnight process.</p> <p>“We perform quality assurance reviews, an evaluation of the IA department against best practices to come up with what Internal Audit should be doing to be more efficient and effective,” says Karim Mahedi, Director, Advisory Services. “We have a tool we call PwC Profiler where we carry best practices from up to 500 organizations where we’ve done this before so we can show clients where they stand against their peers. As a result, we can help build the case for change.”</p>
The right cultural mindset	<p>Different organizations are going to be at different places on the transformation map. Some will be further ahead in anticipating the change while others are still stuck on the compliance and financial focus and need a new way of looking at it.</p> <p>“For us to help create a value map we need to look at the long term strategy and understand the vision but more importantly we have that interaction with senior management at the organization to see where the challenges are going to come from down the road and where IA can contribute and help manage situations,” says Wetmore. “Part of that process is to get the buy in from the rest of the organization for the transformation IA is going through.”</p>
The right technology solutions	<p>There are two pieces of technology that make sense for any Internal Audit department: a good data analysis tool; and a good documentation tool. We at PwC have a tool that we use to document, review and archive work paper documentation as well as IT consultants with the expertise to help companies streamline, interconnect and improve their IT systems.</p> <p>“Before we do a transformation we like to identify ways to take out 20 to 25% of the IA department’s cost and invest that in the transformation so that the organization is not spending anything more than what they were already spending,” says Arun Gupta, Director, Internal Audit Services. “In effect they get more value at the same price.”</p>

Our team

In Alberta, PwC has assembled a team with significant Internal Audit experience in helping clients benchmark and transform their internal audit departments. We help our clients become cost efficient as well as more focused on critical stakeholder value areas which can contribute to overall business success. Call one of our practitioners below to talk about how we can help your internal audit department.

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