

10Minutes on Maximizing Internal Audit*

What you need to know about emerging topics essential to your business. Brought to you by PricewaterhouseCoopers.

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Enhanced role key to reducing risk, optimizing cost

Highlights:

- The recent financial crisis has lifted enterprise risk management to the top of nearly every board's agenda.
- Companies are embracing a more strategic, top-down view of risk management, integrating Internal Audit into their overall plans.
- Transforming its focus, resources, and mindset is key to helping companies meet the risk challenge.
- In a time of constrained resources, refining the internal audit function is yielding risk-management and business process improvements.

The bursting of the financial asset bubble, combined with the meltdown of the economy and resulting regulatory response, has led more boards and CEOs to search for ways to upgrade risk management. To facilitate this process, they are challenging Internal Audit to raise its game.

With financial reporting control processes generally well established and stabilized, broadening Internal Audit's mandate would appear logical. Yet it will require shifting its focus to a more strategic role, combined with tone-at-the-top support from management and the Audit Committee.

In this issue of 10Minutes, we suggest ways to overcome some of these challenges and realize risk management and efficiency benefits in the process.

Four ways to maximize Internal Audit

1. Task it with clarifying emerging risks in key areas, including execution of new growth strategies, stress-testing of new processes and implementation of proposed regulatory changes.
2. Focus its efforts on core business drivers and opportunities for process improvement, cost savings, revenue enhancement and cash flow.
3. Structure and empower it to cut across and connect functional lines.
4. Strengthen its relationships and communications with other governance, risk, and control functions.

At a glance

The recent financial crisis demonstrated the need for a strong, objective, more qualitative risk management process. In the wake of the crisis, boards and CEOs are undertaking a strategic review of risk management, questioning whether Internal Audit can provide the additional qualitative oversight needed.

Issues to be explored

- Can Internal Audit deliver more value?
- Is it helping the organization to improve operations?
- Does it have the stature to generate change across silos, sectors, technology platforms and jurisdictions?
- Does it have the right skills and resources?
- Is Internal Audit sought out for its enterprise risk management insights?

Solutions

- Focus internal audit function on emerging risk areas
- Align its efforts to the company's strategic business objectives
- Further develop its responsibility for improving processes, obtaining savings, enhancing revenue, and improving enterprise cash flow
- Enhance its efficiency of audit processes

01

A risk wake-up call

The bursting of the financial asset bubble and the resulting economic downturn provided a powerful lesson about risk and risk management to many of the world's most prominent companies. For financial institutions, one painful lesson was the risk of over-relying on quantitative financial models.

This risk wake-up call has not been lost on boardrooms. According to the 2009 *What Directors Think* survey, conducted by PricewaterhouseCoopers and *Corporate Board Member* magazine, more than 60 percent of respondents said unknown risks now represent the greatest challenge they face as directors.

Matching strategy and risk mitigation

In the wake of the financial crisis, a growing number of CEOs are elevating enterprise risk management on their “to do” lists. While methods and approaches may differ, many are embracing a more strategic, top-down approach to governance, risk, and compliance. The goal is to ensure strategies are matched by the right level

of risk mitigation. In response, they are bringing Internal Audit into the mix to take advantage of its assurance role and ability to help the organization improve core business operations.

Now that financial reporting processes and controls have been established, this new role would appear to fit Internal Audit well. But at ground level it will require evaluating the business with a broader risk management lens using a staff heretofore charged primarily with financial and operational compliance monitoring.

Nevertheless, many companies are pressing ahead. In some cases, a broadened focus is turning up savings and process improvements. These enhancements are becoming competitive advantages, similar to how Six Sigma helped some companies cut waste and optimize effectiveness.

To achieve these objectives, Internal Audit must transform its focus, its resources, and its mindset.

02

Refining the focus

Strategic and business issues are responsible for 60 percent of losses to company value, with operational issues driving another 20 percent, according to PricewaterhouseCoopers 2009 *State of the Internal Audit Profession* study. Yet Internal Audit resources often remain focused on lower-risk, routine compliance processes and issues.

These existing resources can play an important role in reducing strategic and operational losses if charged with a new risk-responsibility mandate that aligned with the company's goals and strategies.

Aligned with risk drivers

The internal audit function has several qualities that align well with key risk drivers. For one, no matter how grand the strategic vision nor how extensive the automation, risk management ultimately comes down to enabling better, risk-informed decision making. The traditional structure of the function typically cuts across functional lines and has direct reporting relationships to senior management and the Audit Committee.

Under the top-down approach, Internal Audit can play a central role when senior management perceives a systemic weakness or potential missed opportunity. On the flip side, if a problem were detected, it would analyze whether the issue is a single hole in the organization's armor or indicative of a more pervasive business issue.

To live up to this potential, Internal Audit must do more of the work that directly affects the business model and strategy. It must have the right people in place to do higher level work. And it must be able to connect the risk dots in ways that are proactive and preventive rather than reactive.

03

Aligning resources and mission

To get more out of Internal Audit, companies need to provide a different mix of resources and skill sets than traditionally allocated.

Although financial accounting and auditing skills remain highly important, these skills alone are insufficient to provide the type of risk monitoring and analysis needed to carry out an enterprise risk mandate.

Chief Audit Executives (CAEs) say this mission will require a different kind of employee, according to the PricewaterhouseCoopers 2009 *State of the Internal Audit Profession* study.

Upgrading employee skill sets

To succeed with a new mandate, CAEs say they will need high-performing, well-rounded professionals capable of “thinking outside the box.” They will also need individuals who have the business knowledge and confidence to engage in substantive conversations with senior management, line-of-business executives, and the Audit Committee.

Earning a seat at the table

Maximizing the impact on the organization requires Internal Audit to inform and contribute at the leadership level.

Delivering this value-add, and thereby earning a seat at the leadership table, requires professionals with the requisite skills, including communication and project management skills, and expertise in dissecting complex issues.

In the near term, however, with budgets squeezed in nearly every department, few CAEs expect to see more funding. Yet most welcome an expanded internal audit mission and believe they can meet higher expectations through greater co-sourcing of internal audit activities.

04

Making the transition

Internal Audit may also need to reassess its processes and enterprise-wide perception. It begins with changing and internalizing the new focus and moving beyond its comfort zone.

Internal auditors will need to bring improved business and operational skills as well as deep ability to leverage data and technology. For example, many of the routine tasks currently performed within the internal audit function can now be automated using governance, risk, and compliance technology solutions. By investing in these applications, Internal Audit personnel will be freed up to serve as knowledgeable risk management consultants.

Done differently, Internal Audit can be seen as an even more important ally in the organization's efforts to enhance risk management and improve business execution.

Some early adopters are pushing this transition full bore, while others are driving it through pilot projects.

Refining the approach

One company's pilot project discovered entirely new risks to audit. In doing so, it improved the department's relevance to and coverage of strategic risk.

Another company improved the balance of Internal Audit resources between traditional compliance needs and identified important concerns or opportunities, resulting in significant shareholder impact.

So has the time come to challenge the risk management status quo? Answers to the following questions may provide some insight.

- What is your perception of the internal audit function and its people? Could they deliver more value?
- Does Internal Audit contribute sufficiently to your ERM initiative?
- Is it providing valued risk insights or is it too focused on routine reporting?

Upcoming 10Minutes topics

Business continuity

The best disaster survival manual may be obsolete if it doesn't anticipate major disruptions to the supply chain or at outsourced operations. 10Minutes explores how business continuity management (BCM) programs are being designed to continually assess—as well as counter—risks stemming from the interdependencies integral to running a business.

Creating more value from HR

The link between effectively deployed talent and business results was never more apparent than during the financial crisis, as strong leadership by key decision makers enabled many firms to perform better than their competitors. 10Minutes discusses how companies can better align their human resources model to the strategic goals of the business in four key areas: brand, corporate vision, financial performance, and employee performance measurement.

Executive compensation

After nearly two decades, the pay-for-performance model is being revisited, as regulators and Congress aim to better align corporate compensation structures with risk considerations and sustainable performance. 10Minutes looks at how proposed rule making and legislation are likely to change not only compensation programs but also how companies define performance.

How PwC can help

To have a deeper discussion about how enhancing Internal Audit can reduce risk and optimize cost, please contact:

Tell us how you like 10Minutes and what topics you would like to hear more about. Just send an email to:
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