

What's Next for Internal Audit

**...lessons learned from the economic
crisis and the challenges that lie ahead...**

Presented to:

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Topics

- A decade in retrospect
- Impact of the current economic crisis
- 10 key challenges in the year ahead
- Beyond the current crisis: planning strategically for the long-term
- Final thoughts

The Past Decade: An Extraordinary Journey for Internal Audit

- 1999: “Bull Market” and Y2K
- 2001: Terrorism, BCP, and disaster recovery
- 2002: Enron, WorldCom, and Cynthia Cooper
- 2002-2003: Sarbanes-Oxley and PCAOB
- 2004-2007: SOX, SOX, and SOX
- 2008: Implosion of the economy
- 2009: Economic crisis; realignment of coverage

Adapting to the “New Definition”

1999

INTERNAL AUDITING REDEFINED

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 processes.

2009

Controls

Enhanced proficiency in assessing controls were byproduct of SOX

Risk

Internal audit's proficiency in assessing risks has increased dramatically

Governance

Internal audit's role in corporate governance is still evolving

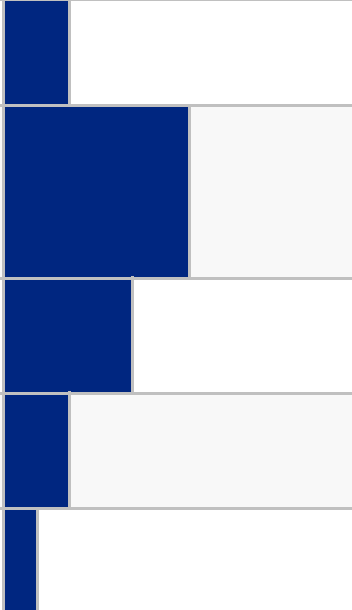


Impact of the Economic Crisis on Internal Auditing



Lessons Learned from the Current Crisis: Impact on our Companies

- 87% of respondents report that their companies have been negatively impacted
- 41% report moderate or worse impacts (55% of F100 respondents)
- 4% indicate that impacts threaten the future of their companies

Response	Chart	Frequency
Little to no impact		13%
Mild - revenues/profits decreased by less than 20%		42%
Moderate - revenues/profits decreased by 20 - 50%		29%
Severe - revenues/profits decreased by more than 50%		12%
Enterprise threatening		4%

GAIN Survey: March 2009

Negative Financial Impacts Companies are Experiencing from the Current Economic Crisis Could have been Prevented by Better Risk Management:

Response	Chart	Frequency
Strongly Disagree		14.1%
Disagree		29.3%
Neutral		26.4%
Agree		21.5%
Strongly Agree		8.7%

GAIN Survey: August 2009

Lessons Learned from the Current Crisis: Impact on our Internal Audit Budgets

Observations

- 2008 and 2009 have witnessed little overall growth and notable reductions in some internal audit activities
- 2010 promises little relief
 - Projections are it will reflect the lowest instance of growth since pre-SOX
 - Almost 20% of all respondents and 17% of F1000 project outright declines in 2010

All Respondents

	Increased	Stable	Decrease
2008	35%	52%	14%
2009	26%	42%	32%
2010	21%	60%	20%

Fortune 1000

	Increased	Stable	Decrease
2008	35%	50%	15%
2009	26%	39%	35%
2010	19%	64%	17%

GAIN Survey: August 2009

Contributing Factors to the Economic Crisis

- Extraordinary latitude by management to define risk appetite and accept risks for the enterprise
- A corporate governance model that did not emphasize the board of directors' role in risk management
- An overriding emphasis by external and internal auditors on effectiveness of financial controls following financial failures of early 2000's



Key Challenges for Internal Auditing in the Year Ahead

Five Key Challenges in the Year Ahead

1. Aligning internal audit coverage to meet new expectations
2. Realigning skills to address new requirements
3. Coping with diminished resources
4. Demonstrating value and adding to the bottom line
5. Maintaining stature with the audit committee

1. Aligning Internal Audit Coverage to Meet New Expectations

Areas of Increased Coverage

Areas of Increased Coverage	2008-2009	2010
Financial risks (general)	36%	42%
Operational risks	57%	57%
Compliance risks	36%	46%
Credit risks	39%	21%
Liquidity risks	30%	21%
Effectiveness of risk management	27%	46%
Company exposure to third parties in financial distress	51%	30%
Cost/expense reduction or containment	49%	45%
Off-shoring/vendor risks	26%	23%
Reputational risks	32%	32%
Supplier or counterparty risks	46%	38%

GAIN Survey: August 2009

2. Realigning Skills For New Requirements

The Challenge

- Shifting coverage requires different skills:
 - Knowledge of the business/operations
 - Better understanding of risk management
 - Deeper understanding of specialized risks
- CAEs have also identified new priorities:
 - Data mining and analysis
 - Risk assessment
 - Information technology
 - Risk management
 - Fraud detection



2. Realigning Skills For New Requirements

Implications and Strategies

- Acquisition of new skills is underway
- Staffing strategies must:
 - Address emerging skill requirements
 - Align with corporate HR strategies
 - Position for future success
- Rotational staffing models are gaining popularity as swift means of infusing knowledge of business
- Alternative sourcing strategies are also gaining traction

2. Realigning Skills For New Requirements









The required Internal Auditor skills of the future:

- **Risk Taker**
- **Boardroom Presence**
- **Variety of Experience**
- **Courageous**
- **Visionary**
- *High Level of Certification*
- *Practical*
- *Strong Leadership Skills*
- **Innovative and Creative**
- *Strategic Thinker*
- **Excellent Grasp of Business Risks**
- *Influential*
- *Motivator*
- *Arbitrator*
- **Team Builder**
- *Unquestionable Ethics and Integrity*
- *Flexible*
- *Disciplined*



3. Coping with Diminished Resources

The Challenge

Response	Chart	Frequency
Reducing contracting and administrative expenses		45%
Reducing or eliminating co-sourcing support		47%
Reducing travel expenses		79%
Reducing training expenses		69%
Freezing or reducing staff compensation		63%
Imposing a hiring freeze		45%
Laying off internal audit staff		33%
Other		12%

GAIN Survey: March 2009

3. Coping with Diminished Resources

Strategies for Success

- Take a “holistic” look at your department – don’t “salami slice”
- Take a hard look at:
 - Structure and processes
 - Procedures – particularly use of technology
- Take an innovative approach to professional development and other HR practices
- Consult with your stakeholders – where do they get value?
- Update your risk assessment before making staffing reductions
- Communicate the plan and impact to the audit committee before implementation
- Above all - maintain a risk-based focus

4. Demonstrating Value and Adding to the Bottom Line

The Challenge

- Pressures on the “bottom line” have never been greater
- Management is looking to internal auditing to identify fraud, waste, and inefficiency
- 49% of respondents report an increase in cost containment and expense reductions during the past year
- 45% expect further increases in 2010
- The challenge for internal auditing is to swiftly identify actionable opportunities to enhance the bottom line
- This presents an opportunity to demonstrate value

4. Demonstrating Value and Adding to the Bottom Line

Potential "Low Hanging Fruit"

- Organization control structure/span of control
- Contract administration
- Construction and capital projects
- Outsourcing agreements
- Sales Commissions
- Vendor payments and contract compliance, including duplicate payments
- Overtime payments
- Revenue assurance
- IT infrastructure
- Additional streamlining of SOX compliance

5. Maintaining Stature with the Audit Committee

The Challenge

- Stature with audit committees has been enhanced in the past decade
- Audit committees have been keenly focused on financial controls
- Internal auditing's shifting focus creates a threat that some audit committees will lose interest

5. Maintaining Stature with the Audit Committee

Strategies for Success

- Ensure the audit committee drives or embraces a broader focus on risks
- Involve the audit committee in discussions on risk assessment results and changes to internal auditing's coverage
- Ensure internal auditing's charter aligns with potential coverage
- Reinforce the strong value that a comprehensive risk- based approach to internal auditing coverage will bring

Beyond the Current Crisis: Planning Strategically for the Long-Term

Planning Strategically

The Mandate

- Internal auditing is a dynamic and evolving profession
- A “high-performing” internal auditing activity in 1999 would be average in 2009
- The “curve” is constantly shifting
- Staying on the leading edge requires a strategic view of the future



Planning Strategically

Key Objectives

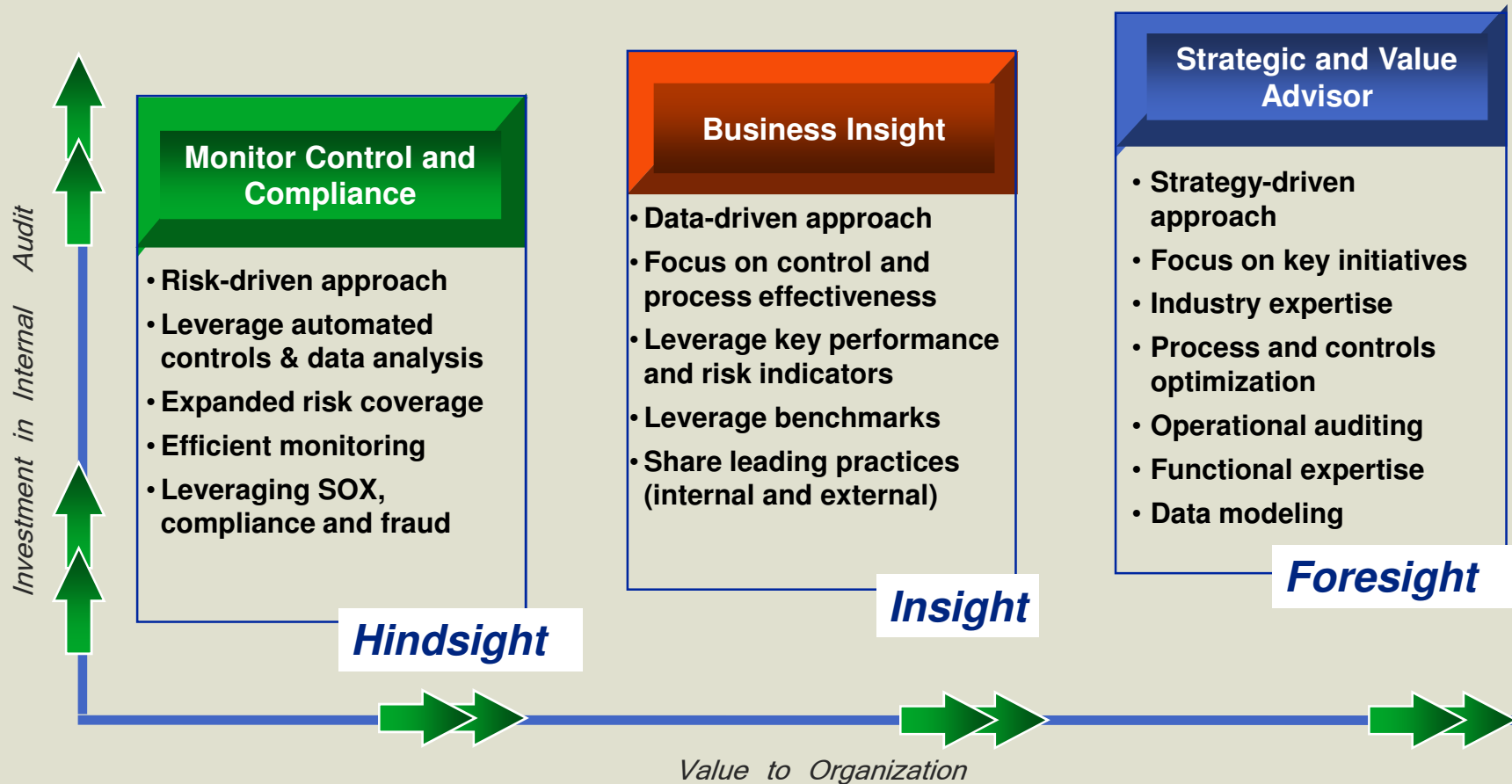
- To position internal auditing for success in a dynamic, uncertain environment
- To stimulate creative thinking about the future
- To turn around or stimulate performance
- To align internal auditing with the strategic thinking of the enterprise

Strategic Considerations

- Who are internal auditing's stakeholders?
- What is their current needs and expectations?
- How are those expectations likely to evolve over 3-5 years?
- What is the strategic outlook for the enterprise?
- How are enterprise risks likely to evolve?
- What key capabilities or disciplines will internal auditing need to possess?
- How will they be obtained?
- What is the vision for internal audit?
- What are the key strategic objectives necessary to achieve the vision.
- How will progress be measured?

A Parting Thought

Stakeholders will look to us for balanced focus between compliance and business improvement, with more emphasis on business improvement



Questions



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