



Transforming Internal Audit to Drive Business Performance

21 June, 2011

Agenda

- Stakeholder Needs from Survey Data
- Linking Business Performance to Internal Audit
- The Role of Risk Management
- Becoming a “Strategic and Valued Advisor”
- Unlocking the Value of Internal Audit Examples
- Value Charter/Value Scorecard Considerations
- Steps to Transformation
- Self Diagnostic



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

- 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



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

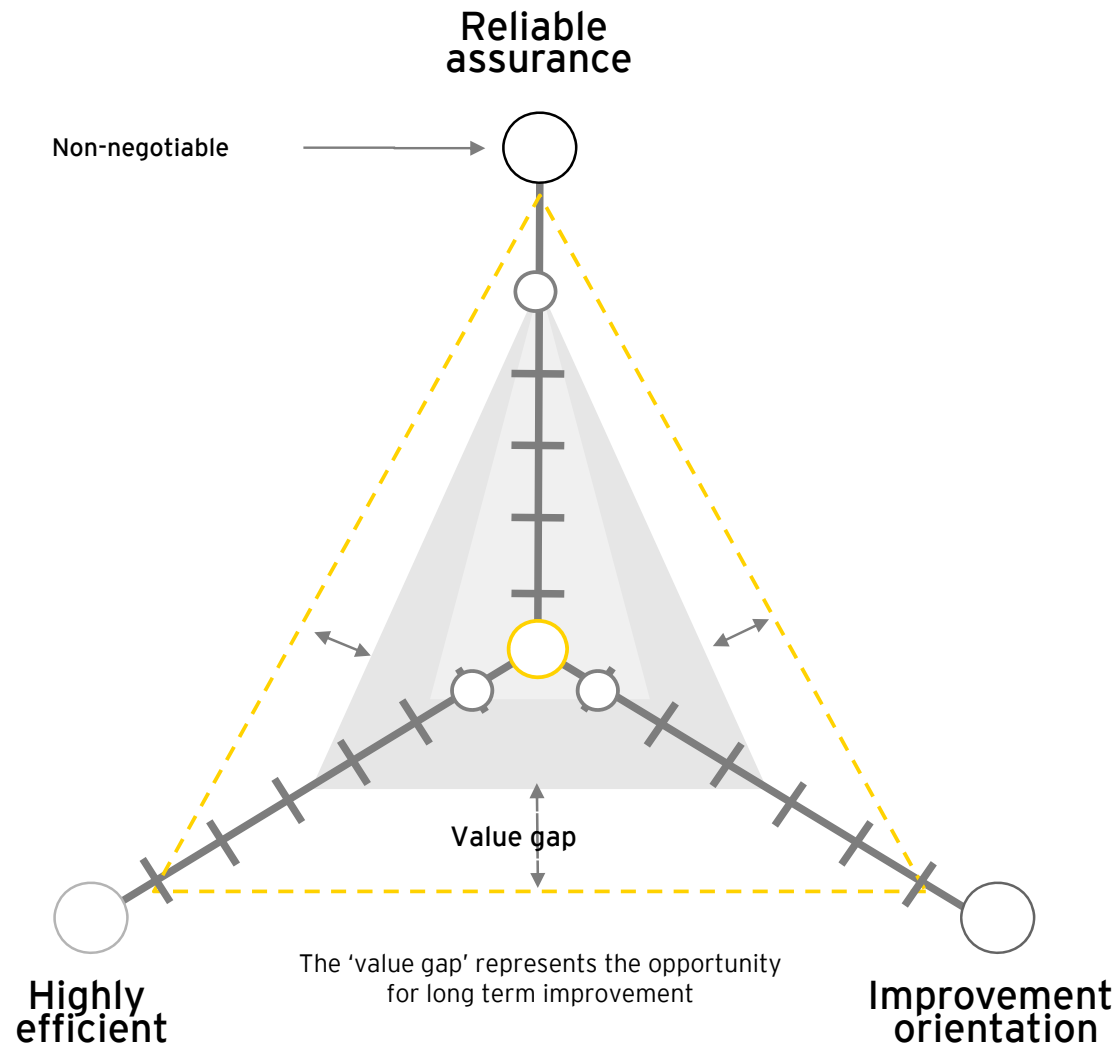
Source - VERSION 11 May: Ernst & Young Risk Survey conducted in April and May 2010 with Global Audit Committee Members, CEOs and CFOs

Executives are asking

- ▶ Does my internal audit function ***understand their key stakeholder expectations?***
- ▶ Is my internal audit function ***contributing to address our key business objectives?***
- ▶ How do I know I am getting ***value*** from my internal audit function?
- ▶ How can internal audit help to get ***better risk coverage for less cost?***
- ▶ Should my Internal audit function be ***responsible to help add value and improve my business?***
- ▶ Does my IA function have the ***appropriate influence*** on my overall control environment?
- ▶ Does my internal audit function have the ***right skills in the right places?***
- ▶ How can ***information technology*** help internal audit do a better job?
- ▶ 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?***

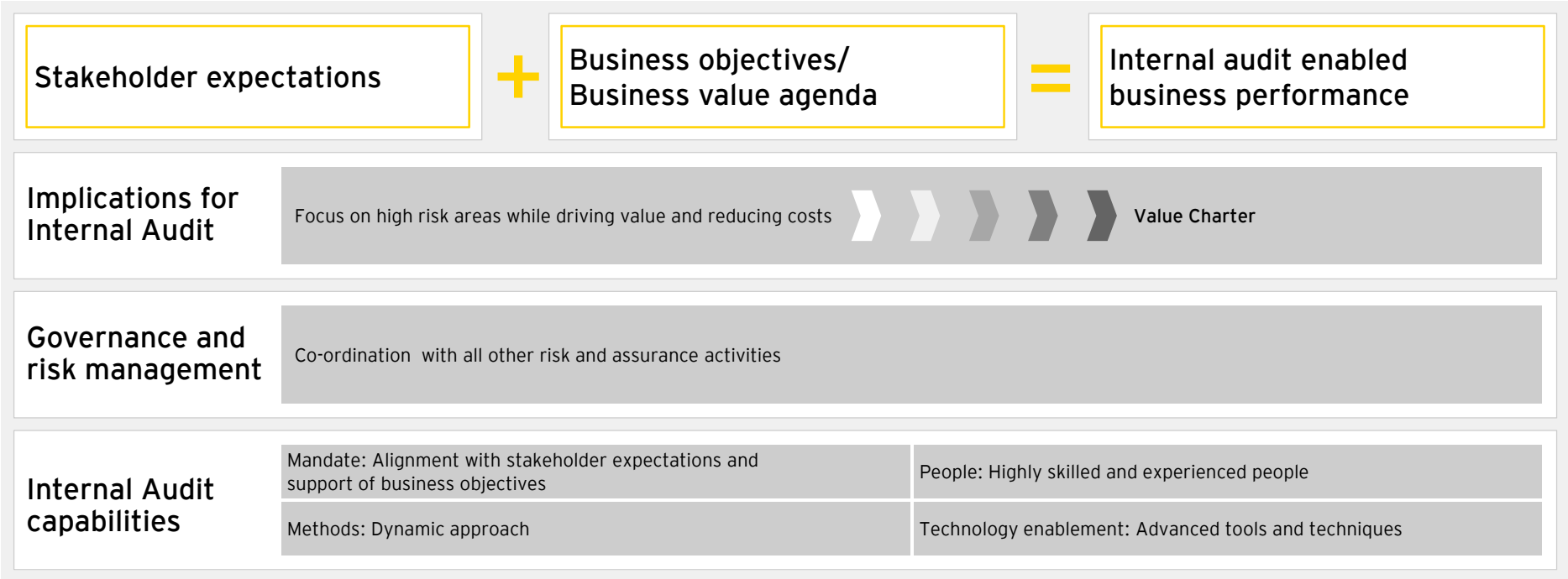


Internal audit addressing stakeholder needs

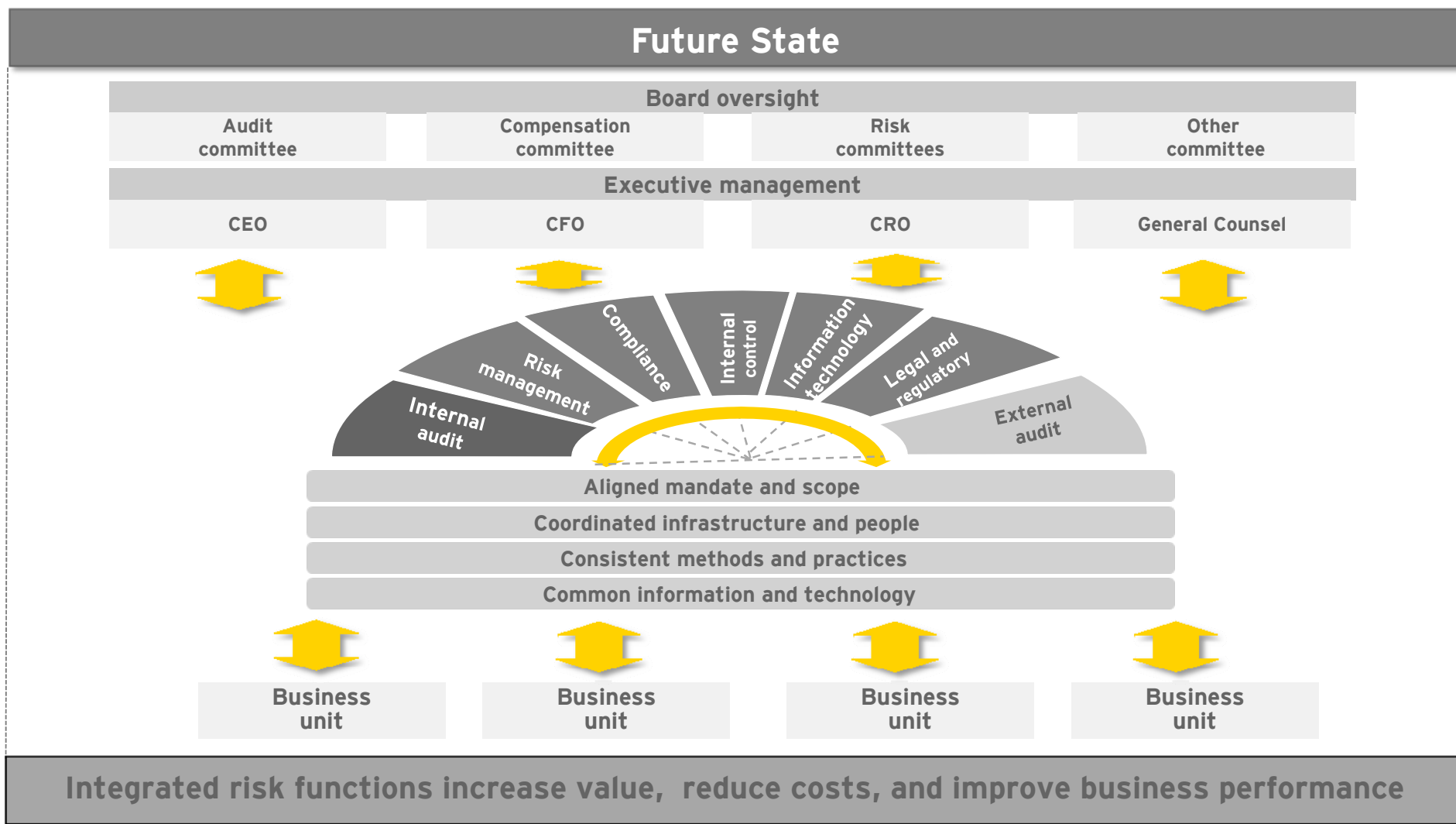


Linking business performance to internal audit

Internal audit enables improvement to business performance



Aligned and integrated risk management activities can lead to improved business performance



Risk Coverage - Mapping accountabilities for key risks

Representative Example - Risk Coverage Map

Aligning the key risks to the organizational roles and responsibilities is ultimately critical to determining opportunities for enhancement.

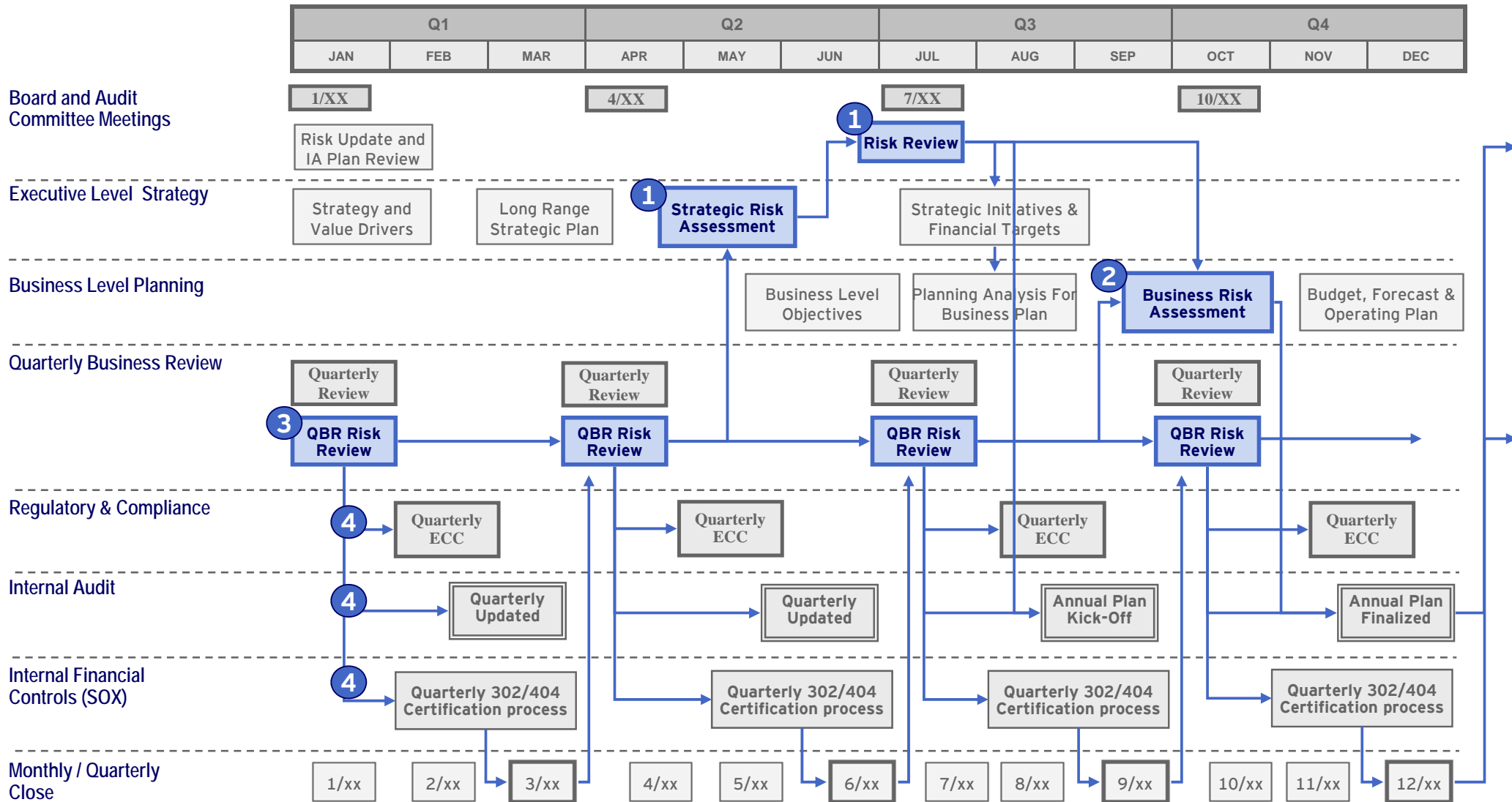
Risk and Control Framework Assessment - Risk and Control Activity Mapping																				
Significant Risks	Business Operations					Support Functions					Monitoring				Oversight					
	New Product Development	Gain New Business	Procurement	Production	Product Delivery	After Sales Support	Finance and Accounting	IT	Tax	Transactions	HR	Legal	Internal Audit	Internal Control	Corporate Compliance	Other Risk Functions	Executive Management	Board	Audit Committee	Risk Committee
TIER 1																				
International Expansion		☒					☒		☒			☒	☑	☑	☑	☑	○	○		
New Product Development	☒	☒															○	○		
Raw Material Price Volatility													☑	☑		☑				
Foreign Exchange Rates			☒				☒						☑	☑			○	○		
Interest Rate Volatility			☒				☒						☑	☑					○	
Contract Terms/Conditions		☒	☒	☒	☒							☒	☑	☑	☑	☑				
Recruitment & Retention		☒	☒	☒	☒						☒				☑		○	○		
Regulatory Compliance															☑			○		
Health/D...																		○		

☒	Primary Owner	☒	Support	☑	Monitoring	○	Oversight
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	Potential Inefficiencies		Potential Coverage Gap
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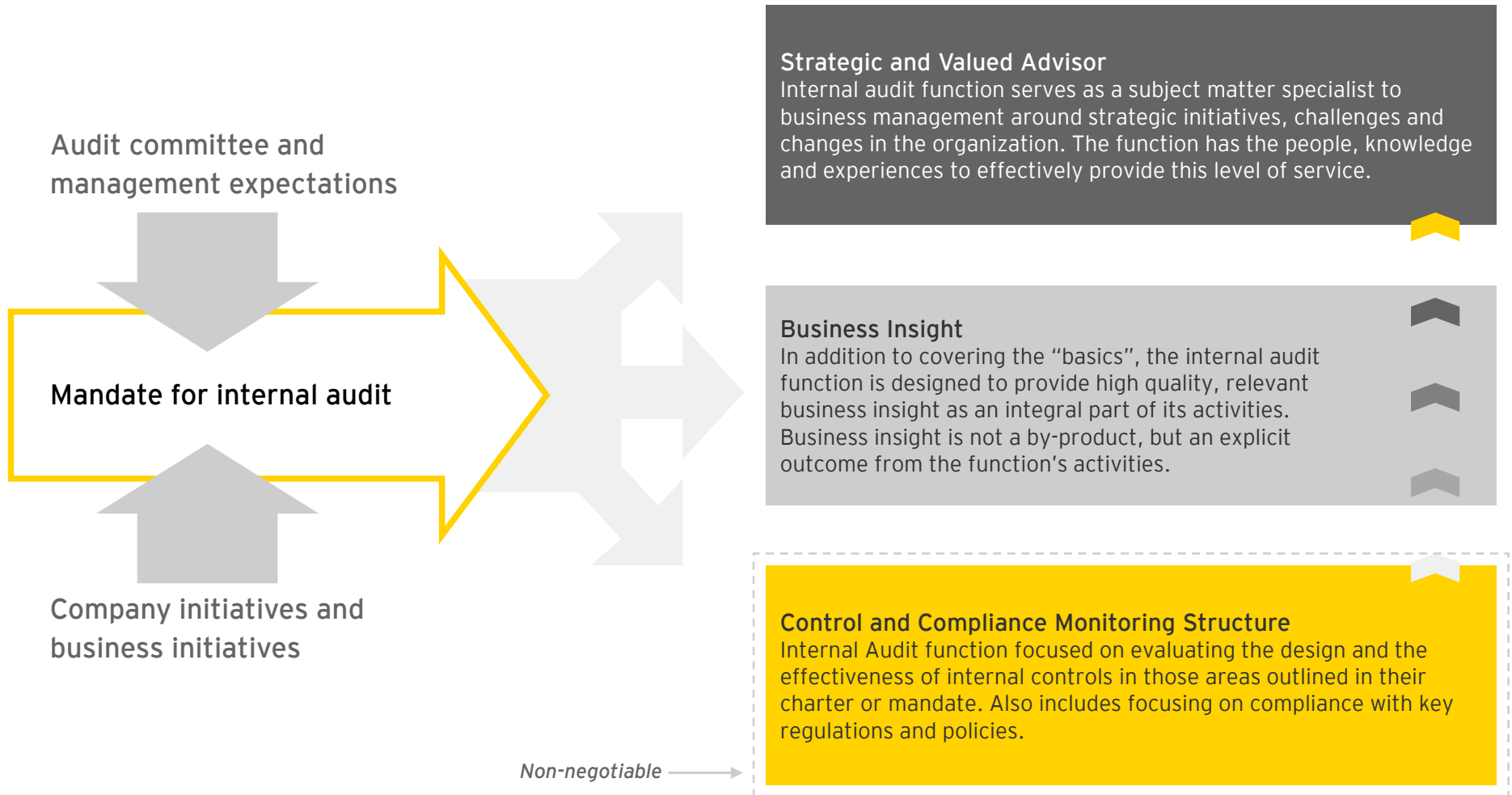
Calendar Overview - "Rhythm Of The Business"

Key points of integration for incremental enhancements



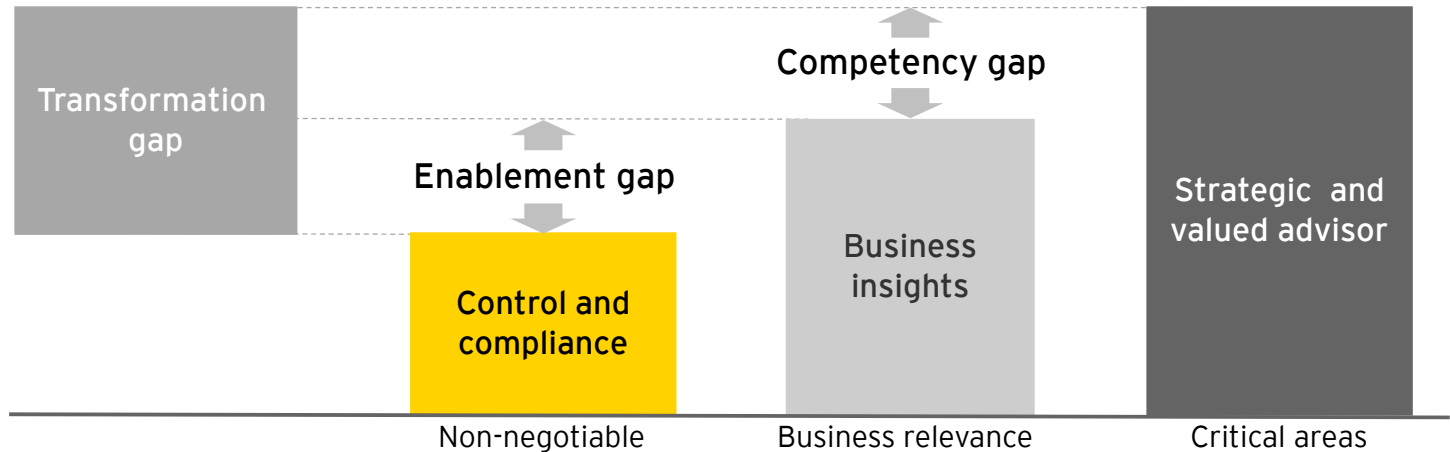


Internal Audit as a valued business advisor



Closing the gaps

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.



What drives the gap?

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

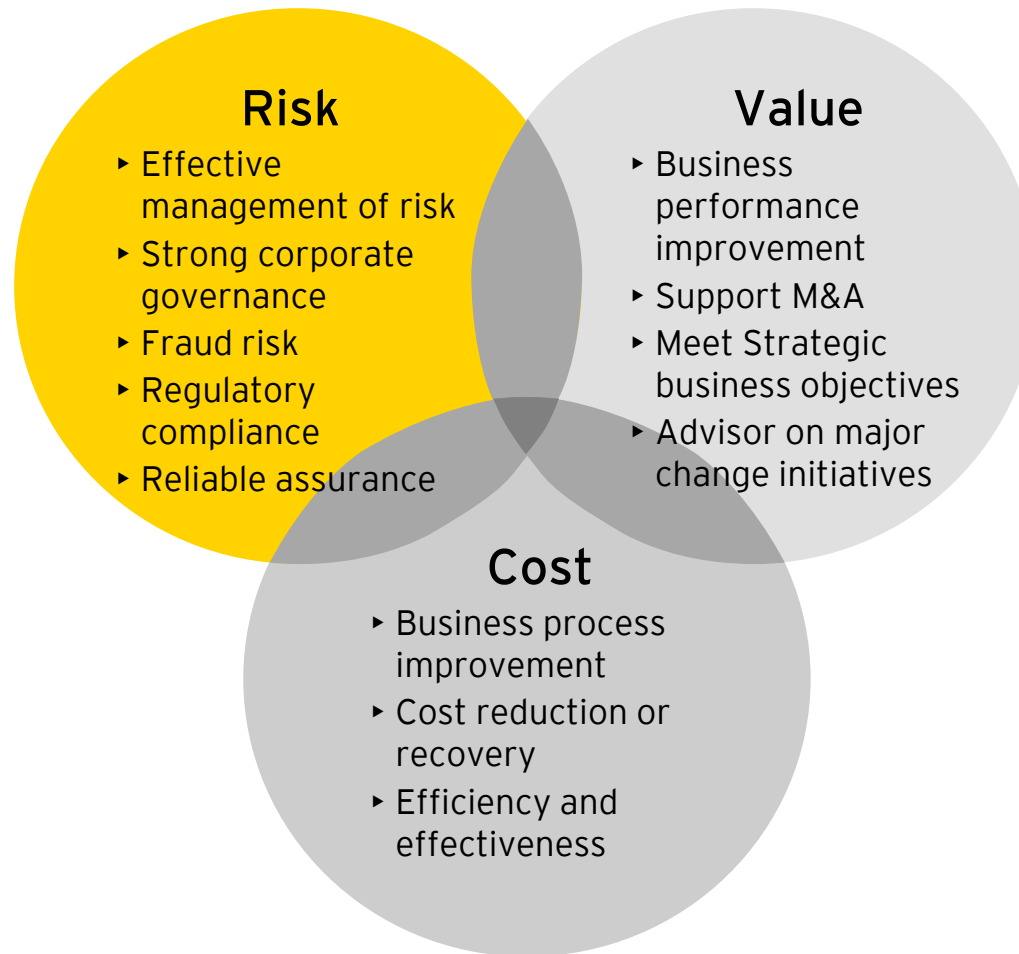
Enablement gap

- ▶ 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.



Stakeholder expectations of internal audit

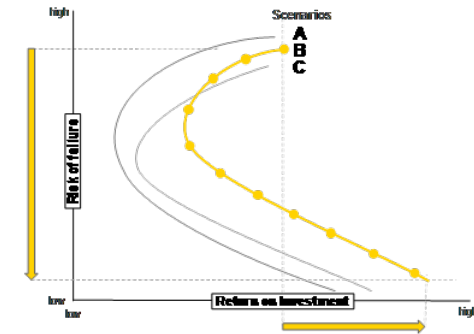


Unlocking the value

Aligning internal audit with business objectives

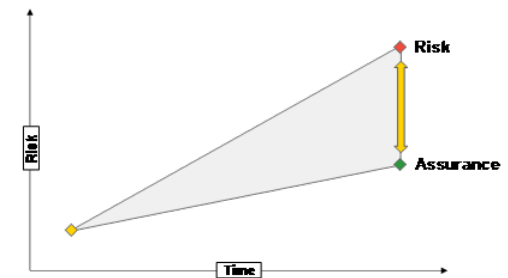
Example value objectives

- ▶ 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



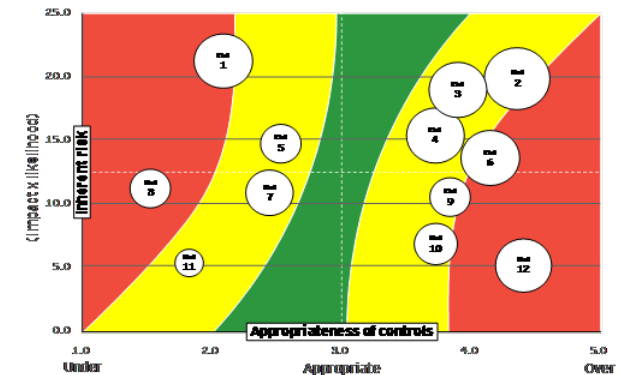
Example risk objectives

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



Example 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



Case study - Internal audit and major capital programs

A seat at the table prior to and during implementation

The business objective(s):

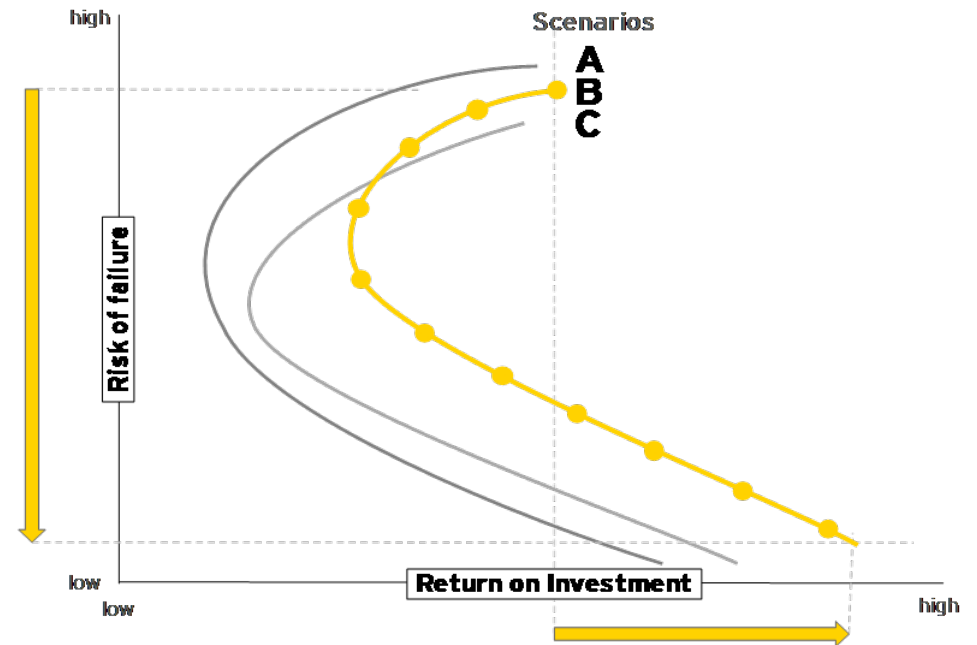
- ▶ Return maximum on investment in major capital program
- ▶ Achieve ROI/ROC as quickly as possible while minimizing disruption to existing business operations

The focus of Internal Audit:

- ▶ Participate in pre-implementation and ongoing program execution by providing controls consultation, efficiency monitoring and test of intended new controls
- ▶ Help management reduce the overall risk of failure by monitoring key risks to the program as well as long-term risks to the business process(es) affected by the major change

The results (benefits/impacts):

- | The results (benefits/impacts): | Value added |
|---|-------------|
| 1. IA helps to reduce the risk of failure (cost overruns, program milestones not achieved), failure to meet stakeholder expectations) by monitoring "program risk", that is, those risks that are inherent in large capital projects. | ✓ |
| 2. IA, by monitoring risks that would otherwise cause major delays in program execution and benefits realization, actually enables speed-to-ROI/ROC. | ✓ |
| 3. IA is a true "partner" with the business, seen as a true consultant skilled in leveraging internal leading practices across the enterprise. | ✓ |



True story ...

Objective - Execute a major rollout of SAP on a worldwide basis across 5 waves and 3 years. Do so with maximum efficiency and little disruption to the business.

IA's role - Dedicated five (of 40) Internal Audit team members (two IT) and a Program Risk SMR. Participated in company program (including PMO) from very start. Consult on controls and test new risk profile.

Bottom Line - Not only did IA and the SMR help the company achieve the intended results/benefits of the rollout, it established itself as a value-added contributor (and consultant) of leading practices and key skills.

M&A Risk Assessment Process

Corporate M&A Strategy
(8-10 deals/year)



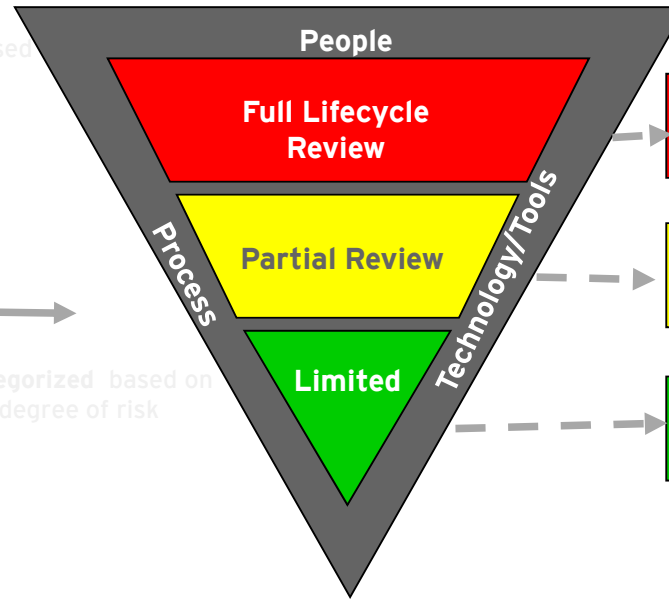
Deal profiles and characteristics are assessed based on established risk criteria

Typical Risk Assessment Criteria:

- ▶ Deal Size
- ▶ Deal Type
- ▶ Timing
- ▶ Speed of integration
- ▶ Synergy targets
- ▶ Geographical locations
- ▶ Resource experience
- ▶ Product/service offering
- ▶ Stakeholder expectations



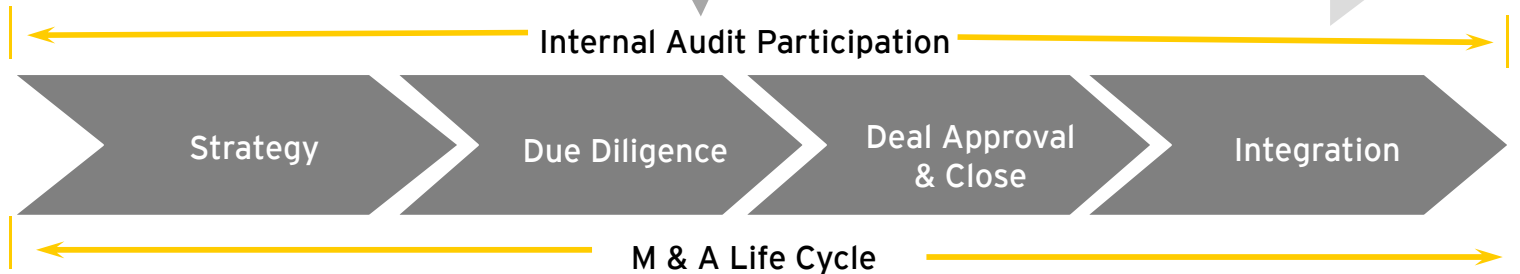
Deals are categorized based on inherent degree of risk



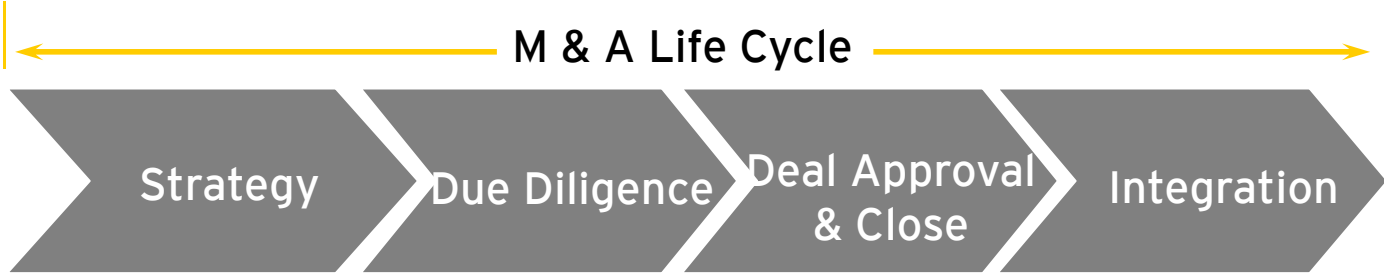
- ▶ End-to-End M&A lifecycle participation
- ▶ Participation at riskier stages in the deal lifecycle
- ▶ Participation in ad hoc or requested reviews

Outcome:

- ▶ Process Improvement
- ▶ Deal value confirmation/acceleration
- ▶ Link to strategy
- ▶ Measurement
- ▶ Mitigation of value leakage
- ▶ Stakeholder assurance



Corporate Audit M&A Role Framework



Objective

<ul style="list-style-type: none"> ➤ Assess corporate strategy process. ➤ Assess the risks to the organization. ➤ Assess business case process. 	<ul style="list-style-type: none"> ➤ Assess valuation process. ➤ Assess risks and internal control environment. ➤ Assess synergy validation process. 	<ul style="list-style-type: none"> ➤ Assess deal approval process. ➤ Assess monitoring of valuation process leading up to close. 	<ul style="list-style-type: none"> ➤ Assess integration planning process. ➤ Assess integration project management. ➤ Assess and monitor integration execution. ➤ Transaction value assessment (post-integration).
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Case Studies

- 1. Synergy Validation
- 2. Synergy Tracking
- 3. Synergy Quality
- 4. Look Back ROI

Implications for internal audit

Example value charter for internal audit

Vision Statement

Business Value Agenda / Objectives

- ▶ People
 - ▶ Highly Engaged Workforce
 - ▶ World-class Safety
- ▶ Performance Product & Process
 - ▶ #1 in Quality
 - ▶ Market Leadership
 - ▶ Market-leading Availability
- ▶ Profitable Growth
 - ▶ Revenue
 - ▶ EPS Growth

Critical Success Factors

- ▶ People
- ▶ Quality
- ▶ Product
- ▶ Velocity
- ▶ Distribution
- ▶ Emerging Markets
- ▶ Macro-economic



Value Charter

Value Attributes for Internal Audit:

- ▶ Leadership Development
- ▶ Subject Matter Knowledge
- ▶ Training and Certification
- ▶ Utilization
- ▶ Audit Relevance to Risk that Matter Most
- ▶ Efficiency and Effectiveness of Audit Process
- ▶ Value Impact on the Business (process improvement)
- ▶ Business Relationships, Insights and Advisory Focus
- ▶ Six Sigma Principled
- ▶ Risk Coverage

Value Scorecard Measures:

- ▶ Staff Placement/Attraction to/from Business
- ▶ SMR's Leveraged in the Audit Project(s)
- ▶ Training Hours, CPE's and Certifications attained
- ▶ Team Headcount and Utilization
- ▶ High Risk Areas Addressed
- ▶ Issues Monitored and Closed (H/M/L)
- ▶ Recommendations Made and Implemented
- ▶ BU Executive Interactions and Key Initiative Inclusion
- ▶ Costs Contained/Recovered and Revenue Enhancements Identified/Implemented
- ▶ Emerging Market Insights and Red Flags monitored and reported

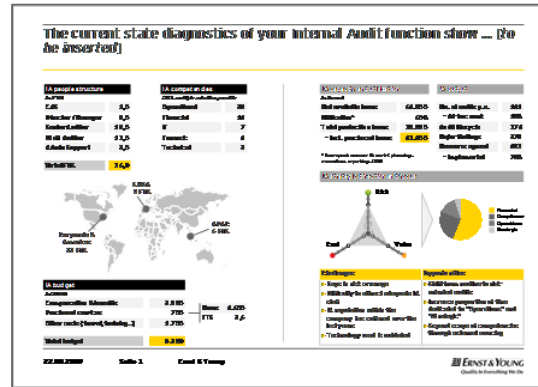
Three steps to Internal Audit Transformation "Continuous Improvement"

Link Internal Audit to the Business Value Agenda

Build the business case for change

Create a plan that focuses on value, measurement and accountability

Value Charter	
Value Attributes for Internal Audit: Leadership Development Subject Matter Knowledge Training and Certification Utilization Audit Relevance to Risk that Matters Most Efficiency and Effectiveness of Audit Process (Special Requirements) Value Impact on the Business (Special Requirements) Business Relationships, Insights and Advisory Focus Six Sigma Principles Risk Coverage	Value Scorecard Measures: Staff Recruitment/Attrition In/From Business SME's Leveraged in the Audit Projects Training Hours, CPE's and Certifications obtained Team Headcount and Utilization High Risk Areas Addressed Issues Monitored and Closed (N/A's) Recommendations Made and Implemented BU Executive Interactions and Key Initiative Inclusion Costs Contained/Recovered and Revenue Enhancements Identified/Implemented Emerging Market Insights and Red Flags monitored and reported

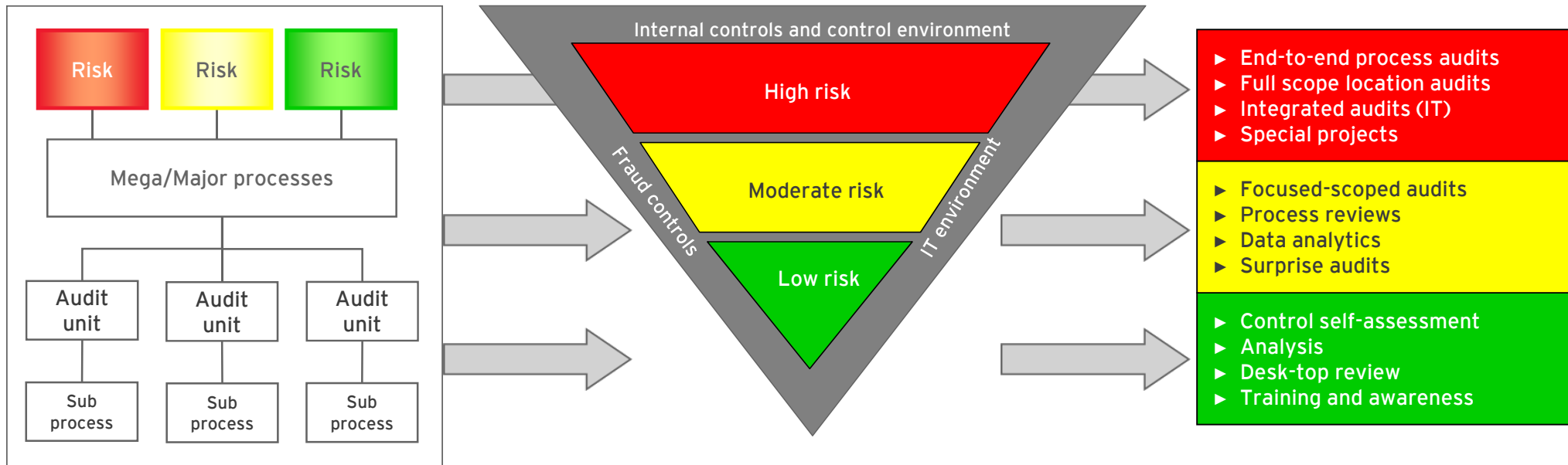


Results of self-assessment / scorecard

Area	Target	Current	Future
Leadership	4.5	4.2	4.8
Subject Matter Knowledge	4.5	4.3	4.7
Training and Certification	4.5	4.1	4.6
Utilization	4.5	4.0	4.5
Audit Relevance to Risk that Matters Most	4.5	4.4	4.6
Efficiency and Effectiveness of Audit Process (Special Requirements)	4.5	4.2	4.7
Value Impact on the Business (Special Requirements)	4.5	4.1	4.6
Business Relationships, Insights and Advisory Focus	4.5	4.3	4.7
Six Sigma Principles	4.5	4.2	4.8
Risk Coverage	4.5	4.4	4.6

Risk based Internal Audit approach

Leverage the audit planning risk model to determine the appropriate means by which to staff and execute the detailed audit plan to drive a more efficient deployment of limited Internal Audit resources. The majority of Internal Audit resources should be deployed to address the most significant risks.



Self-diagnostic - Ability to meet stakeholder needs

Focus area	Basic	Evolving	Established	Advanced	Leading			
Stakeholder expectations	Internal audit stakeholders and expectations may be narrowly defined		•	•	•	•	•	Internal audit is proactive in challenging stakeholders to expect more from risk functions
Business objectives	Internal audit activities may not be aligned to achievement of business objectives		•	•	•	•	•	Internal audit is seen as a trusted advisor and is well positioned to help the business achieve its objectives
Internal Audit enabled business performance	Internal audit activities are primarily focused on risk and compliance		•	•	•	•	•	Internal audit focuses on the risks that matter, enables value creation and supports cost reduction
Enablers <ul style="list-style-type: none"> ▸ Mandate ▸ People ▸ Methods ▸ Technology 	The internal audit operating model is functional but has known areas of weaknesses		•	•	•	•	•	Internal audit is characterized by developing the skills of future business leaders, uses consultative audit approach and leverages advanced tools and technology

- Focus on risks that matter
- Alignment to business objectives
- Create competitive advantage

- Lower costs
- Greater efficiency
- Less complexity

- Broader risk coverage
- Improved coordination
- Proactive approach