Metamorphosis
Revitalising internal audit
to drive performance
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Internal audit needs to become an integral part of driving and supporting business strategy. But how can the function quickly break out of the compliance chrysalis and evolve into a fully fledged leadership role that delivers real value to your business? Ernst & Young’s transformation model broadens internal audit’s focus to include strategic and operational risk as well as business improvement.

In the current economic climate, the biggest risk for most companies is not failing to meet their compliance requirements - but failing to meet their strategic targets. This is the opinion of over 100 industry analysts from more than 20 disciplines who contributed to The 2009 Ernst & Young business risk report. The report assesses the top 10 business risks for 2009. In it, the analysts conclusively ranked the credit crunch aftershocks and the deepening global recession as the most important business risks for 2009 – displacing regulation and compliance from the top spot.

The implications of this new business risk environment are far-reaching for internal audit, to the point where leading organisations have already begun the process of repositioning the function. Many companies are expanding internal audit’s focus to cover assuring these strategic risks and business performance targets. This requires internal audit to consider strategic and operational risk, including strategy alignment, operational effectiveness and efficiency. Stephen Helberg, Head of Corporate Assurance at Rio Tinto says, “Traditional internal auditing is outdated and in the last 10 years we have seen considerable stagnation in the profession. Organisations and their shareholders now demand that internal audit delivers real, tangible commercial value whilst also ensuring compliance.”

For organisations that still see internal audit as a “tick-the-box” function, this leadership role may seem like a quantum leap. But forward thinking companies started recognising the potential for internal audit transformation long before the global financial crisis. In July 2008, Ernst & Young’s Global Internal Audit Survey (GIAS) – of 348 companies across 23 industries – revealed internal audit functions were already being re-tooled to shift them from compliance to business improvement.

For example, in early 2007, Helberg began innovating Rio Tinto’s internal audit function, using Ernst & Young’s 12-step transformation model. “My vision was for Rio Tinto’s internal audit to be recognised as a benchmark for corporate assurance; influencing change and providing objective risk and control assurance to the organisation,” said Helberg.

According to Helberg, using the model to transform internal audit, Rio Tinto has achieved greater clarity on reporting, greater transparency, more effective audit scopes and better planning. The model also helped to identify skill deficiencies and allow the internal audit function to prove how it was adding value to the business. At the same time, internal audit has been able to play its part in cost control, without compromising risk management or compliance.

Internal audit transformation process overview

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Program governance
Change management/communication/stakeholder management
Project management
Peer program
Quick wins
For those unable or unwilling to go through a full transformation project, the model allows you to tackle transformation gradually, with standalone pieces able to deliver substantial benefits. Three inter-related initiatives most likely to deliver quick wins are:

1. Integrate with Enterprise Risk Management (ERM)
While the Institute of Internal Auditors (IIA) talks about “risk-based auditing”, many organisations take this to mean identifying the risks that matter and putting them on their audit plan. But this is only half the story. True risk-based auditing integrates internal audit with enterprise risk management, both in identifying the risks that matter and driving the form and structure of the audit response. Integrating these disciplines (as opposed to the business units) provides the organisation with valuable recommendations on risks, controls and costs.

2. Re-engineer audit response
The starting place here is to consider and formally articulate internal audit’s options for responding to risk and controls. Techniques range from verbal audit response (e.g., giving advice at steering committee meetings) to business education, to substantial audits. The responses are not mutually exclusive - often internal audit teams use a combination. The point is to make the function recognise where it can add value; to make people aware of all the techniques at their disposal.

Formalising these different audit responses often highlights skills gaps. The 2008 GIAS survey concluded that many internal audit teams don’t have the right skills to audit strategic risk. For example, people often lack business acumen, or the interpersonal skills required for “water cooler” conversations.

3. Conduct value-added audits
The IIA defines internal auditing as an independent, objective assurance and consulting activity designed to add value and improve an organisation’s operations. Within this context, another quick win is to conduct audits which can clearly demonstrate value-add.

For example, at an early stage in Rio Tinto’s transformation journey, their internal audit function demonstrated how they could add tangible value by conducting an “end-to-end” audit of their procure-to-pay process. In addition to examining the control environment of the procurement function, they also examined the effectiveness and efficiency of the function, identifying millions of dollars in potential “value leakage”. This represented a significant return on both the cost of the review, and the cost of transforming the internal audit function. Over time, the mindset of senior executives will change from “internal audit as a cost” to “internal audit being a good investment”.

Consider behavioural issues
At its heart, internal audit transformation is a process of culture change. In fact, a crucial part of re-engineering the audit response is to assess the maturity of not just processes, but also behaviours. Applying a behavioural maturity model helps internal audit teams to identify control risks and better understand their role in managing control risk. By considering behaviour, process improvements are more likely to become embedded in the culture and sustainable over time.

For those willing to tackle behavioural issues, the results are often startling. According to Peter Wilkinson, Manager, Portfolio Risk Branch, Department of Education and Early Childhood Development, Victoria, “The behavioural auditing recommendations from

Ernst & Young transformed the impact of the report. The visual snapshot of behavioural findings created a ‘light bulb’ moment for project committee members.”

Conclusion
Internal audit has an opportunity to contribute even more significantly to your organisation’s value, strength and resilience by transforming into a risk-focused role. The key to realising these benefits is using a transformation model to quickly create a balanced focus between compliance and business improvement and to define and develop the additional competencies and behaviours required for strategic leadership.

Eventually, internal audit will take a leadership role, prompting a holistic review of your organisation’s entire control structure. The end goal of the transformation journey is a combined assurance model, delivering a balanced, cost-effective control environment.

In reality, few organisations attempt all stages of transformation at once. For that reason, Ernst & Young’s transformation approach has been developed in a modular fashion. Look out for future articles which will address specific modules of the internal audit transformation journey:

• Assessing the maturity of your internal audit function
• Auditing behaviours to make control change sustainable
• Re-engineering audit response, including end-to-end auditing
• Integrating ERM and internal audit
• Combined assurance and the cost of control

Does your internal audit function need to be revitalised?
If you are hearing any of the following you may need to revitalise your internal audit function:

• Why do I see so many auditors?
• Why do we pay auditors so much to tick boxes?
• We look at this anyway!
• Auditors just bayonet the wounded!
• Unforeseen risks continue to hurt us

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