Business School
Corporate Governance Series

March 2010

# King's Counsel*
## Internal audit

## Steering Point

The King Committee on governance issued the *King Report on Governance for South Africa – 2009 (the "Report") and the King Code of Governance Principles* – 2009 (the "Code") together referred to as "King III" on 1 September 2009.

The issuance of King III was necessitated by the new Companies Act of South Africa and the changes in international governance trends that have emerged since the release of the second King Report on Corporate Governance for South Africa (King II) in 2002.

King II effectively dispensed with the notion of cyclical compliance-based auditing and embraced a risk-based approach. As this approach has matured over time, the imperative to appropriately position risk-based auditing is a central focus of King III. The repositioned risk-based approach directs internal audit to address strategic, operational, financial and sustainability issues in its quest to deliver value to the organisation. Value is now seen to vest in the relevance of a function.  As such, the head of internal audit needs to understand the organisation's strategy and to direct the function accordingly.

Inside



The Companies Act, 2008 (which constitutes the redraft of the Companies Act, 1973) was assented to and signed by the President on 8 April 2009. The Act will come into operation on a date which is yet to be fixed by the President.

*connectedthinking

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## Internal audit in the context of King III

Today's uncertain business environment as well as King III recommendations makes optimising the value of internal audit an essential imperative for the enterprise.

Governance is underpinned by an acceptance of accountability and responsibility for action. Accordingly, the chief audit executive is required to provide an annual assessment of an organisation's control environment. This reflects calls for the congruence of introspection from the internal audit fraternity with improved governance in general – highlighting the calls for internal audit to rise to the challenge and deliver on its contribution to effective governance!

## Summary of King III principles, recommendations and practical considerations

| **Principle 2.1**<br>**The board should ensure that there is an effective risk-based internal audit** | |
|---|---|
| **Recommendations** | **Practical considerations** |
| • The board should demonstrate how adequate assurance was obtained on an effective governance, risk management and internal control environment; in the event of the absence of an internal audit function. | For an internal audit function to be risk-based and effective, it should have the following key performance indicators (KPIs):<br>• The internal audit function should be guided by an internal audit charter approved by the audit committee;<br>• The internal audit strategy should be aligned to the strategy of the organisation;<br>• The internal audit strategy should be risk-based and its plan should focus on areas that are most likely to impact stakeholder value;<br>• The internal audit function should have an adequate and suitable skills set to implement the risk-based plan;<br>• Internal audit assignments should be conducted in accordance with Standards of Professional Practice on Internal Audit (SPPIA);<br>• Internal audit should report functionally to the audit committee and administratively to the CEO;<br>• Leveraging appropriate technology in the performance on internal audit becomes non negotiable;<br>• Organisations should seriously consider an independent quality assurance review of their internal audit function. This process will highlight any areas for improvement in respect of best practices in the market and will also assess the level of compliance with SPPIA;<br>• If there is no independent quality assurance, then internal audit must provide effective assurance on governance risk, management and the internal control environment. In this case, the board should explain the reasons for its decision and explain how adequate assurance was achieved. |
| • A senior or executive or director to be responsible for internal audit where internal audit is fully outsourced. | In the case of an outsourced internal audit function, the chief audit executive can either be the CEO, the CFO or any other member of the management team who is capable of managing the outsourced internal audit function. |

| **Principle 2.2**<br>**Internal audit should follow a risk-based approach to its plan** | |
|---|---|
| **Recommendations** | **Practical considerations** |
| • Internal audit planning should be informed by the strategy of the organisation. | Transformational auditing is an effective approach to ensure that a risk-based approach to developing the internal audit plan is followed. The organisation's key value drivers need to be identified and the internal audit plan should focus on areas that are most likely to impact stakeholder value. |
| • The chief audit executive should discuss the adequacy of resources and skills available to address risks identified with the audit committee. | The audit committee should ensure that the internal audit function is fully resourced with the relevant skill sets required to address the risks identified. The audit committee, in consultation with the chief audit executive (CAE), should consider various sourcing models in the event of a shortage of adequate internal audit resources and specialist skills within the organization. Options include full outsourcing, co-sourcing, outsourcing and secondments. |

| **Principle 2.3**<br>**Internal audit should provide a written assessment of the effectiveness of the company's system of internal controls, risk management and controls over financial reporting** | |
|---|---|
| **Recommendations** | **Practical considerations** |
| • Internal audit should form an integral part of the combined assurance model and should provide to the audit committee, a written assessment on the effectiveness of the company's system of internal control and risk management, as well as provide an assessment on controls over financial reporting (i.e. internal financial controls). | The audit committee should consider the maturity of other functions such as ethics, risk management, sustainability, etc with which internal audit is expected to interact, to ensure that internal audit is effective in coordinating a combined assurance view.<br>Leadership, strategic inquisitiveness and other attributes will need to drive the expectations of the CAE. This, coupled with strong analytical skills and the ability to negotiate and interact at the highest level of the organisation will enable the internal audit function to position itself to assume its rightful place to lead a combined assurance initiative. |
| • This is required so that a statement from the board can be made on the effectiveness of internal controls in the integrated report. | The audit committee, in assessing both the internal control environment and the internal financial controls, will have to review results from a number of assurance providers, including management.<br>Combined assurance is about assurance providers working more closely together to ensure the right amount of assurance, in the right areas, from people with the best and most relevant skills, as cost effectively as possible. |

| | |
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| • The statement from the audit committee on the effectiveness of internal financial controls is also to be included in the integrated report. This statement should be supported by a formally documented annual review of the design, implementation and effectiveness of the company's system of internal financial controls following suitable testing performed by internal audit. Further, the statement must include the nature and extent of weaknesses in financial controls that are considered material and that resulted in actual material financial loss, fraud or material errors and should also be reported to the board and the stakeholders, in the form of an acknowledgement of the nature and extent of the material weakness/(es) and corrective action, if any, taken to the date of the report. | To meet the requirements for the annual written assessment on the IFCs by internal audit, management should identify the significant accounts, locations and processes over which key controls need to be formally documented, tested and evaluated to ensure that the risk of potential material misstatement is adequately controlled or mitigated.<br>It is management's responsibility to perform the validation and testing of the key controls and it should provide evidence to internal audit so that a written assessment can be prepared for consideration by the audit committee, which must make a recommendation to the board. Alternatively, internal audit can assist management with the scoping, documentation, testing and evaluation of the key financial controls.<br>For the annual written assessment of the control environment to be provided by internal audit to the audit committee, the internal audit plan must be effective enough to cover both an appropriate number of audits as well as cover a spectrum of financial, operational, compliance and performance audits so that internal audit can develop an objective view on the adequacy and effectiveness of the control environment and internal controls.<br>Alternatively, management can perform control self assessments (CSAs) on significant processes and entity-level controls, which internal audit can then validate to prepare the assessment.<br>Internal audit needs to develop and drive a combined assurance model that will support the statements that it is required to make in respect of financial and overall controls. The combined assurance model will also provide assurance to the board and audit committee that the controls that mitigate key risks have operated effectively. King III recommends that the internal audit function play an integral role in developing and implementing this model.<br>The practical aspects of the combined assurance model are addressed in more detail in PwC's *Steering Point* publication on combined assurance. |

**Principle 2.4**
**The audit committee should e responsible for overseeing internal audit**

| Recommendations | Practical considerations |
|---|---|
| • Internal audit pay, bonus and benefits to be determined separately to the process undertaken for the rest of the business to ensure appropriate independence. | Internal audit should report administratively to the CEO and functionally to the audit committee. Furthermore, the audit committee should be consulted in the appointment, transfer, promotion or resignation/dismissal of the CAE. |
| • Internal audit to perform the pivotal role of effecting combined assurance. | The audit committee should consider the maturity of other functions such as ethics, risk management, sustainability etc with which internal audit is expected to interact to ensure that internal audit is effective in coordinating a combined assurance view.<br>Leadership, strategic inquisitiveness and other attributes will need to drive the expectations of the CAE. This, coupled with strong analytical skills and the ability to negotiate and interact at the highest level of the organisation will enable the internal audit to position itself to assume its rightful place to lead a combined assurance initiative. |

| Principle 2.5<br>Internal audit should be strategically positioned to achieve its objectives | |
|---|---|
| **Recommendations** | **Practical considerations** |
| • The chief audit executive to have a standing invitation to attend EXCO meetings as an invitee to protect independence. | To maintain its independence, internal audit should not be involved in operational activities. However, the CAE should be invited to strategic management meetings to enhance his/her understanding of the organisation's strategy as well as his/her agility to address emerging business issues. The CAE should play the role of an observer during such meetings, but without limiting him/her in providing recommendations. There is a strong argument that if internal audit is to be relevant, it must provide assurance and consulting services around the execution of the organisation's strategy. |
| • Internal audit to report functionally to the chairman of the audit committee. | To maintain independence, internal audit should report administratively to the CEO and functionally to the audit committee. Furthermore, the audit committee should be consulted in the appointment, transfer, promotion or resignation/dismissal of the CAE. |
| • Internal audit should establish and maintain a quality assurance and improvement programme. | The CAE should be responsible for implementing and maintaining a quality assessment and improvement programme (QA&IP) in terms of the Institute of Internal Auditors (IIA) Standards. This should include both ongoing and periodic internal assessment of internal audit work. In cases where internal audit is an outsourced function, the audit committee will be responsible for coordinating the external quality review. External assessments should be conducted at least once every five years by a qualified, independent review or review team. These assessments should cover the entire spectrum of audit and consulting work performed by the internal audit function and the results thereof should be communicated to senior management, the CEO and the audit committee. |

## Maximising the value of internal audit while meeting the challenge of King III

This publication outlines a proven approach to rethinking internal audit, to optimising the use of resources to be both more efficient and more effective. Done right, internal audit has the opportunity to reposition itself as a key factor in a broad range of risk and compliance issues in the environment proposed by King III.

Internal audit needs to deliver the right value at the right cost. In other words, it should be optimised in terms of both cost and value. In our experience, a high-performing internal audit function is likely to demonstrate the following attributes:

- A value proposition fully aligned with stakeholder needs and expectations;
- A focus on critical risks and issues;
- A cost-effective delivery approach;
- A staffing/resource model aligned to support its value proposition;
- A process for active ongoing engagement with stakeholders;
- A suitable strategy that leverages off technology;
- A client service culture; and
- A continuous approach to quality improvement and innovation.

## 10-step framework

PricewaterhouseCoopers (PwC) has developed a 10-step framework for optimising an internal audit function. It is clearly applicable in today's environment, but the attributes are universal and relevant whatever the external or internal environment is.

> Internal audit can deliver the greatest value to an organisation when it operates within a strategic framework – when its mission, vision and strategies are aligned with the expectations of its key stakeholders, and when it is able to link to the most significant risks to corporate value. Steps 1-5 focus on refreshing this foundation.

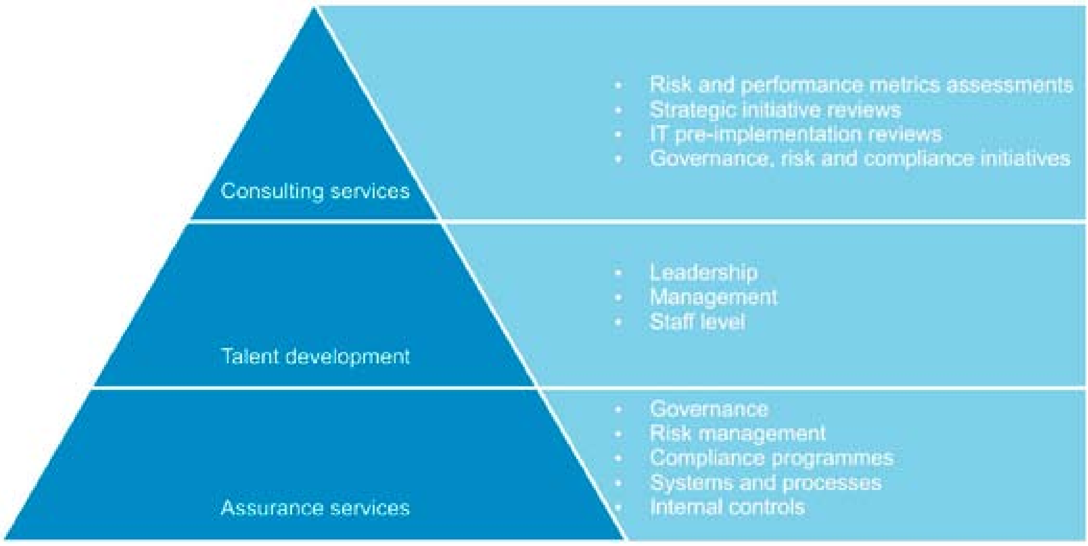
## Step 1: Clarify stakeholder expectations

The first step in building an optimised internal audit function is to engage in a robust dialogue with executive management, the audit committee, external auditors, and where appropriate, regulators. Such meetings help to establish expectations for the internal audit function and clarify how it should add value to the organisation. Unfortunately, we often find that stakeholders are not on the same page, with some having very different expectations of audit than others. If this is the case, there needs to be an effort to reconcile the differences and develop an approach to find common ground.

While the core definition and purpose of internal audit is universal, there is a broad range of interpretations regarding how that is delivered in practice. Internal audit's role should always include providing objective assurance on governance, risk management and control processes, but may also include talent development and providing consulting services. In part, the discussion of scope and focus needs to consider the level of control maturity in the organisation. For many if not most public companies, financial controls are now well established and subject to monitoring, leading many to ask how internal audit can continue to add value to the organisation.

The diagram below highlights areas of potential value for internal audit. The bottom level depicts the foundational internal audit role, focusing on governance, risk management and control over core business processes and systems. Directing internal audit efforts in these areas assists management in protecting the value of the organisation. The remaining levels of the diagram represent the areas where internal audit can enhance value, either directly through consulting services or by its contribution to enterprise talent development

*The internal audit value proposition*




The dialogue with stakeholders should explore their greatest assurance needs, and whether internal audit currently has appropriate resources to address those needs. It should then proceed to consider what role internal audit should play in developing talent for the organisation and, if so, at what levels. Finally, the discussion should consider whether consulting services are appropriate, and if so, on what issues and areas they should focus.

In an environment that is ever changing, it is likely that needs and expectations are too. Audit committee members, in particular, typically sit on several boards, and consequently observe multiple risk profiles and audit functions, so it is important to maintain an ongoing dialogue. Step 9 addresses the development of a relationship plan and management process for all key stakeholders.

## Step 2: Reaffirm internal audit's mission and vision

The internal audit mission statement includes both charter information such as purpose, authority, responsibilities and applicable professional standards, and more aspirational elements such as value proposition, vision and strategic themes. The mission statement serves as a critical internal and external communication tool.

The internal audit charter details how the mission will be achieved, clarifying responsibilities, reporting relationships, access, and independence within the organisation. If internal audit is to play a role in enterprise risk management, including IT, compliance and fraud risks, internal financial control, combined assurance and integrated reporting, the charter should describe the scope of internal audit's responsibilities in these programmes and explain how it will interface with other functions.

The mission statement should also include a value proposition outlining how stakeholders will benefit from internal audit's services, insights, expertise and relationships. Internal audit functions typically have two strategic themes, operational excellence and business partnership. Both are important but typically, one takes precedence in determining internal audit's value proposition.

In either case, following classic strategic thinking, the goal for basic assurance services should be to deliver them as cost effectively as possible. A function providing a business partner value proposition would also deliver a number of high-value consulting projects and value-added insights and advice, in addition to delivering the core assurance mandate effectively and efficiently.

The mission statement should also highlight the high-level goals and initiatives within the strategic themes. Examples would be to:

- Maintain operational excellence by achieving continually higher quality and timely assurance services at a lower cost; and
- Be an effective business partner by delivering deeper functional knowledge and technical skills, while also providing proactive assistance and consulting services.

There are no right or wrong answers regarding which theme takes precedence. Where stakeholders choose to position the function is a reflection of their risk appetite and assurance needs. Thus, the mission statement should be specific to the organisation and its stakeholders' expectations of internal audit.

The strategic elements of the mission statement are not intended to be as detailed as a plan. Rather, they are the compass for the function, serving as a basis for forward looking improvement and a framework within which the strategic plan and performance targets will be determined and measured.

## Step 3: Develop a strategic plan

The strategy for an internal audit function consists of six interrelated components that serve as a roadmap to achieve the mission. In our experience, very few internal audit functions have a clear strategic plan. Without such a plan, time and money are often wasted on piecemeal and ad hoc 'strategies'.

The strategy should be established based on a number of factors and analyses:

- Stakeholder expectations or 'voice of the customer';
- Value proposition and strategies of the enterprise;
- Recent and anticipated changes to the risk profile resulting from external events and strategic initiatives;
- Internal audit benchmarking and quality assessment results; and
- An assessment of internal audit's strengths, weaknesses, opportunities and threats (SWOT).

A good strategy addresses the following six questions:

- How the portfolio and mix of audit services will change over the next two to three years?
- What is in scope today versus in the future? What areas of the extended organisation will be within or excluded from internal audit's domain.
- What talent will be needed to creditably execute the future audit plan, including the mix of skills and experience? Will new skills and experience be developed or acquired from within the enterprise or externally?
- What tools, technologies and process improvements will be required to enable the revised value proposition and service capability?
- How will key efficiency and effectiveness metrics improve during the execution of the strategy? and
- What is the timing and sequence of initiatives to be followed, based on factors such as available resources, urgency and the need for credibility through quick wins?

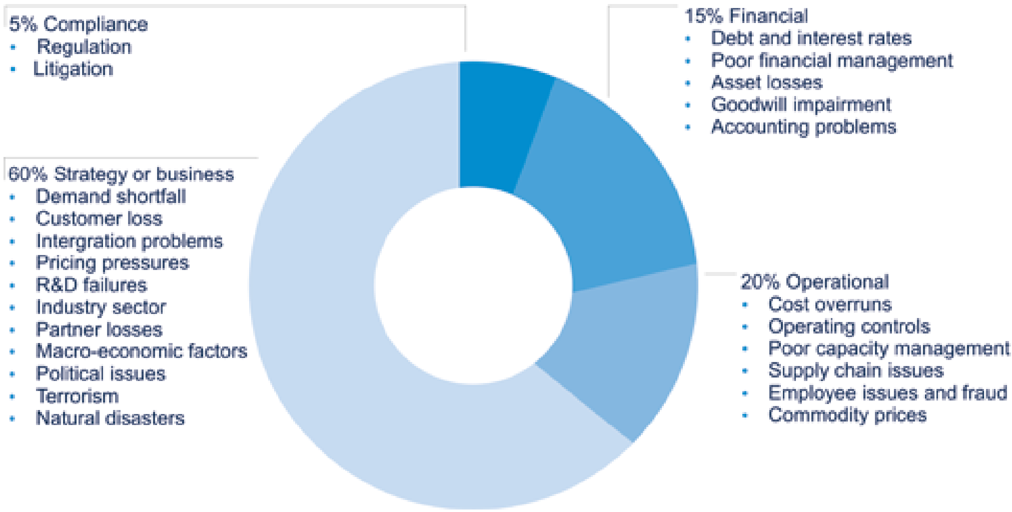
All six of these elements need to align and support each other. Since the ideal time horizon for a strategic plan is likely to be no more than two or three years, it will need to be revisited at least as frequently.

## Step 4: Assess enterprise risks

The origins of the financial crisis of 2008-2009 will likely be debated for some time, but the fallout exposed one clear shortcoming – inadequate governance and risk management practices. Even before the crisis, numerous studies indicated that strategic and business risks pose greater threats to shareholder value than operational, compliance or financial risks.

These studies, which examined the factors behind rapid losses in shareholder value, found that strategic and business issues have been the most common causes of significant shareholder value destruction – and are responsible for 60 per cent of value loss.

*Factors contributing to rapid loss of shareholder value.*




*(Source: PricewaterhouseCoopers, composite of various studies of US and UK market before the financial crisis)*

The same drivers of increased risk – capital mobility, rapid innovation, and globalisation – also enable the opportunities that can be exploited to better satisfy customer demands, increase revenues and improve shareholder value. Thus, the starting point for an effective risk assessment must be a clear understanding of the drivers of the enterprise's shareholder value.

Performing a risk assessment requires defining and consistently applying an approach that is tailored to the organisation. The risk assessment exercise should begin with the establishment of a plan, considering objectives, scope, responsibilities, timing, and input and output requirements. The risk assessment process should obtain input from those that can provide a meaningful perspective on risk. Sources of input should also include available internal and external information, such as analyst reports, prior assessments, loss data and KPI trends. Deliverables and other outputs should be determined according to the requirements of stakeholders.

Once the scoping and planning have been agreed, the execution of the risk assessment process should include the following essential steps:


The risk assessment process should incorporate the following leading practices:

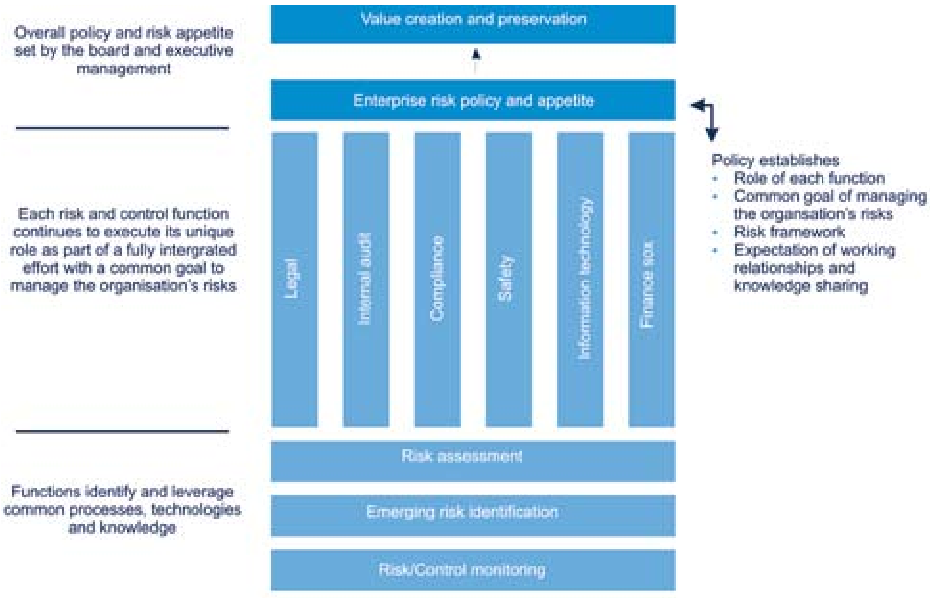
- Perform enterprise analysis
  Such analysis helps illuminate not only the business objectives but also key considerations from the perspective of stakeholders, such as customers and regulators. Objectives are typically laid out in annual reports, strategic plans, presentations to analysts, project and investment plans and functional unit charters.
- Map shareholder value drivers
  This practice provides a critical businessperson's perspective to the information collected in the enterprise analysis. It results in greater clarity and consensus about financial, customer and stakeholder objectives and key people, process and technology objectives and initiatives.
- Leverage other risk assessments
  Results from internal audit's prior risk assessments, and those conducted by others in the enterprise should be considered. In the ideal state, internal audit contributes to and fully leverages an enterprise risk assessment produced under an enterprise risk management initiative.
- Utilise specialised talent
  External specialists can be useful in understanding and assessing both known and emerging risks in areas where internal audit lacks expertise.

## Step 5: Develop a risk-based audit plan

Once an enterprise risk profile and assessment have been completed, the audit plan can be concluded. Unlike the risk assessment, which should reflect management's composite view of risk, the audit plan is solely the provision of the internal audit function. Thus, for example, if internal audit is not as convinced as management that a particular area is as well controlled as management believes, then the audit plan provides the mechanism to test that.

Risk and compliance requirements have grown tremendously over the last few years as have related activities and budgets. This frequently leads to multiple audits and reviews of business units during the year. A good deal of this duplication is unnecessary. To address this, a number of organisations have established integrated governance, risk and compliance initiatives. These organisations seek to enhance both efficiency and effectiveness by establishing certain common activities, standards, and tools, while still enabling each function to deliver on its specific mandate as depicted in the accompanying illustration

*Strategic governance, risk and compliance framework*

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Of particular interest for internal audit planning, is the alignment and even integration of audit or assurance plans, such as compliance, management, external audit and information security. Some leading companies have gone through the exercise of mapping the sources of assurance against the key risks and compliance requirements of the organisation. Another common technique is for internal audit to include audit steps on behalf of other risk and compliance functions, such as safety, in their field audits.

The development and implementation of a combined assurance model will assist internal audit in ensuring that the focus of its plans is risk based and does not overlap with the activities of other identified assurance providers.

If an objective in optimising the internal audit function is to increase the value of work, a proven way is to include audit work related to strategic initiatives in the plan. This is not to question the strategy but to monitor the execution of strategy. While many question whether internal audit has a role to play in strategic risk, initiatives are the execution mechanism of strategy, and like any project or programme, can be broken down and audited. There is a strong argument, based on the studies cited earlier, that if internal audit is to be relevant, it must provide assurance and consulting services around the execution of corporate strategy.

Optimised internal audit functions are also reconsidering the timeframe for their audit plans. Multi-year and even annual plans are a relic of a more stable era. In today's volatile and dynamic environment, shorter planning periods are being adopted to enhance flexibility. One technique we are seeing more frequently is a rolling six-month plan, which provides flexibility to adjust to changing risk profiles and organisational priorities. However, when more flexible planning processes are adopted, it is critical that there continues to be a strategic logic to the plan. Otherwise there is a risk that it will result in significant gaps in the assurance required by stakeholders.

When developing audit strategies and the audit plan, several approaches can increase efficiency and add value, including:

- Question and if possible, eliminate routine, low-value audits;
- Focus compliance audits at the enterprise or programme level to increase organisational relevance and leverage;
- Extend the use of technology tools to automate testing of entire data populations (for example, computer-assisted auditing techniques);
- Conduct top-down testing of controls or areas that provide coverage of multiple risks;
- Implement continuous risk assessment in multi-unit organisations, so that audits are focused on the riskiest units, and/or address common risk themes across multiple units; and
- Determine an audit plan for strategic initiatives. Whether it is assurance or consulting oriented, value can be added by either assessing the robustness of plans and designs, and/or the transparency of reporting.

With the strategic foundation for internal audit refreshed, the 10-step framework shifts to designing, acquiring and developing the necessary resources and enablers. Steps 6-8 focus on detailing the specific resources and then obtaining the necessary funding needed to implement the strategic and audit plans. This includes people, process and technologies. The final steps look at stakeholder relationship plans, and performance targets and metrics.

## Step 6: Detail key resource needs

Having the right people is the key factor determining the successful delivery of value within almost any organisation, and especially, internal audit. To quote from Jim Collins' book, From Good to Great, "'People are your most important asset' is wrong, people are not your most important asset, the right people are." Thus, if there is a need for change in terms of scope of work or stakeholder satisfaction, it is likely that the staffing model will need to be revisited.

As first reported in our 2009 State of the Profession study, internal audit leaders have told us candidly that there is a nagging stakeholder perception that internal audit doesn't understand the business. Coming out of the SOX era, this is understandable as the key skill set required relates to financial reporting related controls. With the transition to a more 'value-added' scope of work, the implication is a need for more experience and a broader mix of skills.

Recent events have also challenged internal audit to demonstrate value in the face of shrinking budgets. As internal audit leaders look to a future addressing broader and more strategic risks, existing skill sets need to be inventoried and realistically assessed for their short and longer-term relevancy. Deferring decisions to upgrade talent, leverage a service provider, or up-skill resources, inevitably results in sacrificing audit coverage and value.

Skill sets should be considered in terms of core and non-core competencies, much like PwC's proprietary Hub & SpokeTM model. The core is defined by answering the question, what and how much do I need of skill sets such as finance, information technology, and engineering? An additional complexity to be factored into the mix is: what type of talent do I need in foreign locations?

One popular approach to enhancing the talent pool is rotational models in which employees from outside of internal audit rotate into the function, bringing with them a different and perhaps better understanding of the business. There are a number of decision factors in designing such a model, but they all should stem from thinking about the output of the programme first. What skill set and experience level would have the most impact on the business, and how many can be graduated in a given period? There is no right answer, but starting with the end in mind is critical to developing the right approach. Equally importantly, this type of programme cannot be driven by or from internal audit. To be successful, it needs a strong executive champion. Additionally, having observed a number of these rotational models over time, we cannot over-emphasise the need to carefully manage all aspects of the programme to ensure successful audit and talent development outcomes.

Beyond getting the right talent on board, is the consideration of the best organisational model to enable the strategy. Finding the right balance of geography, business unit, centralised staff pools, and centres of excellence is an art rather than a science. Internal audit's value proposition and strategic initiatives should be critical data points in the decision tree.

Non-core talent is critical to the success of internal audit but is often a challenge because there is no critical mass or the skill is difficult to acquire and retain. Alternative tactics for acquiring non-core talent include:

- Guest auditor programmes, which utilise independent subject matter experts from within the organisation, on a short-term basis, to assist on audits and use their specialised expertise;
- Off-shoring, to take advantage of labour cost savings and reduce staffing costs (often used for analytical work and routine testing);
- Sourcing from a third-party provider to gain access to teams with specialised skill sets, industry-specific expertise, geographic coverage, and/or staffing flexibility.

In order to build new capabilities and to stay abreast of changes affecting the business, optimised internal audit functions devote significant resources to developing and delivering a training curriculum that considers:

- Alignment of the learning programme with the overall functional strategy;
- Topics that help staff understand the operational side of the business;
- Robust content, allowing just-in-time training to address the changing landscape of functions, systems, risks and team members;
- Consistency and quality of audit delivery, with a focus on producing value as defined by stakeholders;
- Improvement in relationship building, communication, and consulting skills;
- Delivery to a generationally diverse and geographically dispersed workforce; and
- Integration of training and knowledge management.

## Step 7: Develop a technology roadmap

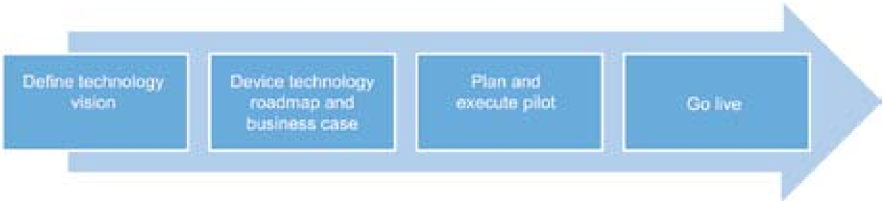
There are three key aspects influencing the use of technology in internal auditing. The first is that technology is almost universally perceived as being critical to increasing both the efficiency and effectiveness of an internal audit function. The second is that it is also widely under-utilised in internal auditing. Thirdly, very few apply the discipline of developing a hard benefit business case before purchasing and deploying technology.

Technology can be applied to virtually every element of internal audit's core and support processes. Some of the tools are audit-specific while others are applicable more broadly in the enterprise. The most commonly deployed audit-specific tools are the audit management platforms such as TeamMate, AutoAudit and Pentana which have broad functionality to support multiple audit processes. In addition, a number of other tools can be deployed effectively in an audit function. These include:

- Data analysis tools such as Excel, Access, ACL, IDEA, SQL, Monarch, Oversight, and the ERP query tools;
- Automated control and segregation of duties testing scripts and tools such as Oracle GRC, SAP GRC, Approva and SailPoint;
- GRC platforms such as Axentus, OpenPages, Paisley, and Resolver; and
- Collaboration tools such as NetMeeting, SameTime, SharePoint, and WebEx, to name just a few.

With so many potential options in today's environment, an optimised internal audit function brings a disciplined business-focused approach to acquiring and deploying technology, with a specific focus on driving efficiencies. One recurring theme with technology deployment in internal audit is the lack of measuring ROI. If a low-growth environment continues for some time as many predict, the pressure on internal audit to do more, will continue. The following diagram outlines the key steps for successful technology investment and deployment.

*Technology roadmap*




While the tools or technologies in themselves are only part of the journey towards a successful deployment, there are a number of other key elements that need to be considered:

- Process
  What issues are we trying to address? What level of project management discipline is needed during implementation? How will this change our methodologies?
- Technology
  What can we better leverage from what is already available to us? What do we need to build, buy, or rent? Is the technology available today and easily deployable?
- Metrics
  What is the ROI for internal audit? For the organisation? How will we assess progress?
- Organisation
  Is this technology to be embedded into every audit (and team)? Should we build a centralised capability?
- Human resources
  What training is required? What new skills are required?
- Communication and reporting
  What impact does this have on our relationship, interactions, and communications with stakeholders and auditees?
- Knowledge management
  How can we share the data and insights within and outside of internal audit?

An optimised internal audit function should also consider what non-technology infrastructure initiatives will help achieve its strategic goals. This includes the development or updating of its policies and procedures, audit methodologies and templates.

## Step 8: Obtain funding commitment

With resource and technology requirements clearly identified and justified, internal audit can have a productive discussion with management and the audit committee about how much audit coverage the organisation can afford, and where audit resources should be allocated.

Funding requests should include cost benchmarks from relevant industry sectors and organisations. Key drivers of audit costs include extent of regulation, global footprint and organisational decentralisation and complexity, thus the benchmark group should align with these factors. Once appropriate benchmarks have been obtained, management and the audit committee should consider their risk appetite, assurance needs and value enhancement opportunities in making their assessment.

The budget request should represent a realistic understanding of the actual resources required to implement the optimisation strategy and audit plan. It is important to reiterate that our experience confirms that there are numerous opportunities for internal audit to add value and enhance coverage while actually reducing costs, a number of which have already been outlined earlier in this publication.

In particular, the budget should reflect aggressive assumptions of resource productivity. While we have identified many tactics to reduce audit costs, many internal audit functions still have very poor project management discipline. As a result, many departments have little visibility into wasted time or costs. Assessing high team utilisation standards and benchmarking average audit project hours will help identify the 'productivity' opportunity.

The budget should clearly differentiate one-time investments from ongoing costs. The budget should also retain the flexibility to respond to changing business needs and key stakeholder priorities and allow internal audit to fight the unexpected fires that inevitably occur. Decisions to scale back internal audit's planned risk coverage (and related costs) should be documented.

## Step 9: Establish a relationship plan

Stakeholders' perceptions of internal audit's value are shaped largely by how effectively the team interacts and communicates with its stakeholders. Despite its criticality, we continue to observe that relationship management and communications are two of the weaker elements of many internal audit functions. Developing an overall relationship and communications plan is therefore key to increasing both the real and perceived value of internal audit. The better and more effective the interactions and communications, the better internal audit can understand and provide assurance and consulting services that effectively address stakeholder and auditee needs, challenges, and align to their business objectives and priorities.

The steps involved in developing a value focused relationship plan include:

- Mapping stakeholder relationships, which includes prioritising stakeholders in terms of their influence on internal audit, and assessing current and targeted relationship strength. The map should also include the primary internal audit owner of the relationship.
- Co-developing individual relationship plans with tactics for maintaining or improving the relationship. These can be derived from meetings to address stakeholder/auditee issues and needs from internal audit. Discussions should centre on the expected business impact, responsiveness, breadth of service and level of expertise and experience. The plan should reflect a mutual understanding of the responsibilities of each party, and include both expectations and commitments of both parties.
- Obtaining regular feedback through a combination of meetings and where appropriate, post-audit and annual surveys. The feedback should include an assessment of accomplishments and areas for improvement, and adjustment to the relationship plan given business changes and feedback. The feedback should also be shared more broadly with the internal audit team to enhance learning.
- Communicating value delivered to ensure at least annually that stakeholders are fully aware of how internal audit has addressed their risks and issues, and the impact of audit's work. This communication should link back to the relationship plans and address the full breadth of audit and consulting projects delivered, as well as ad-hoc advice, training, and best practices shared during the year.

To be successful, it is critical that the plan extends beyond just those with whom internal audit regularly interacts to include particularly the CEO and other members of his or her executive team. That said, interactions at this level need to be carefully thought out and substantive.

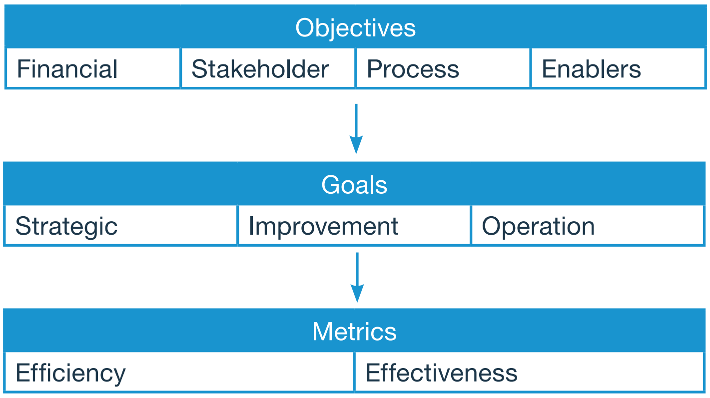
## Step 10: Determine performance scorecard

An optimised internal audit function demonstrates value, results and improvement. Unfortunately, many internal audit functions today do not have a robust set of meaningful targets and metrics.

To measure performance, many commercial and non-profit enterprises have adopted balanced scorecards based on the premise of ‘what gets measured - gets done’. An internal audit balanced scorecard should comprise four dimensions: financial, stakeholder, process, and learning & growth enablers. However, these dimensions are only one aspect of what needs to be balanced. Goals should also be balanced between:

- Strategic goals that align to the main themes in the strategic plan for internal audit for achieving internal audit’s 2-3 year vision. An example would be implementing a rotational staffing model.
- Improvement goals address areas requiring shorter-term focus and visibility, in effect remediation efforts, such as improving the percentage of audits completed on time and within budget from 60% to 90% within a one year.
- Operational goals or standards track the key drivers of day-to-day efficiency and effectiveness, such as reporting cycles and staff utilisation.
- Metrics, which can relate to either efficiency or effectiveness.

The following graphic outlines a holistically balanced approach for designing metrics and a scorecard.




A holistically balanced scorecard should also serve as a basis for annual performance goals that are cascaded to all individuals in the audit organisation, who can then be held accountable for results and rewarded for success. Thus, it is a critical tool for driving and demonstrating value and improvement.

In our 10-step framework we have distilled PwC’s insights gained from years of experience helping leading organisations worldwide to establish internal audit functions and enhance their performance. Over the course of these engagements, this approach has proven highly beneficial to our clients. By leveraging this framework, we believe that you too can create an optimised internal audit function that delivers a significantly enhanced cost-value equation.

## Our services

We have a team of professionals that are ready and able to assist you with the implementation of the requirements of King III in all its aspects.

These include:

- Strategic assurance reviews that go beyond a quality assurance checklist and align to your organisational strategy;
- Assistance in the formulation of a control environment and internal financial controls assessment;
- Assistance in the implementation of a combined assurance model;
- Assessment of internal audit technology leverage;
- Development of appropriate performance metrics for your internal audit function;
- Benchmarking your internal audit function against a community of peers (industry, headcount and revenues);
- Awareness and training;
- Conducting an effective audit of an ethics function;
- Formulation of governance frameworks, including reporting protocols; and
- Optimising the form and content of internal audit communications.

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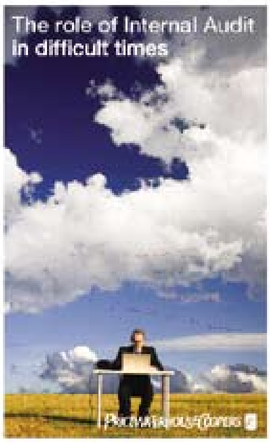
# Publications


*Internal Audit in Brief: The challenge continues*

This is the second edition of Internal Audit in Brief, a newsletter designed to give internal audit leaders a summary of the topical issues we are seeing in the market place.

Apart from the regular articles on regulatory changes, this edition provides insights into:

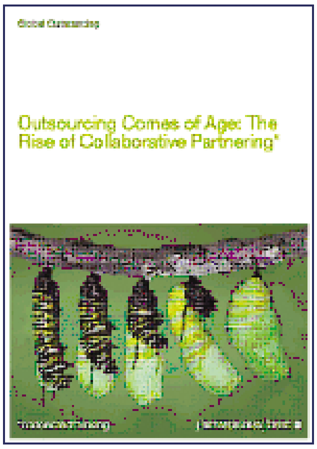
- PwC internal audit surveys – a brief overview of the trends coming out of the recent PwC surveys;
- Human resource strategies – outlining potential alternatives to staff redundancies;
- Contract reviews – a quick guide about how to assess whether your major contracts continue to deliver the benefits they were set up to achieve;
- Continuous auditing – the relative merits of continuous auditing through the use of technology have been debated for a number of years. Some of the issues to be considered are outlined.
- Supplier risks – an increasing number of businesses have experienced significant problems arising from failures of suppliers. What steps can be introduced to mitigate this issue?
- Corruption – outlining the importance of internal audit's role in ensuring senior management is discussing potential corruption, obtaining better information regarding exposures in high-risk market places, and identifying opportunities to reduce risk.




*The role of Internal Audit in difficult times*

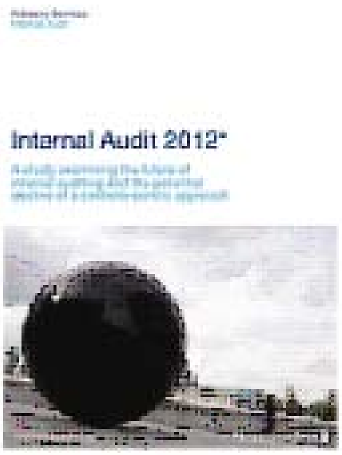
We are currently experiencing an unprecedented economic environment in which the impact of the credit crisis has moved from financial services companies into the broader market and economy.

In these times, it is important to step back and look at the role of internal audit to ensure that it is addressing key risks. This publication provides a checklist that can be used by the chief internal auditors and their teams to assess their ability to add value to the organisation in difficult times. The following questions are addressed: How aware is your team? Does your plan need to change? Do you need to communicate differently? Are you teaming with the right people? Are you taking the opportunity to add more value?




*Outsourcing Comes of Age: The Rise of Collaborative Partnering**

This study explores one of the key issues raised by CEOs in the PricewaterhouseCoopers Global CEO Survey, and reflects insights on outsourcing gathered from executives of both outsourcing customers and providers representing 19 countries across several continents. The study finds that while outsourcing remains a critical element within the corporate strategic mix, success in today's complex outsourcing marketplace is contingent on new dynamics, specifically the customer and service provider relationship.




*Internal Audit 2012*

In the next few years, the value of the controls-focused approach that has dominated internal audit is expected to diminish. As this occurs, internal audit leaders must redefine the function's value proposition and adopt a risk centric mindset if they expect to remain key players in assurance and risk management. These are the central findings of a major survey and interview project PwC conducted to develop a composite picture of internal audit by 2012. Study results indicate that five identifiable trends – globalisation, changes in risk management, advances in technology, talent and organisational issues and changing internal audit roles – will have the greatest impact on internal audit in the coming years. By understanding these trends and their implications, internal audit leaders can help senior management identify and manage risk, thereby providing added value from the internal audit function.


*10 Minutes on Maximizing Internal Audit**

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. This publication suggests ways to overcome these challenges and realise risk management and efficiency benefits in the process.

For further information on these and other publications, please contact your engagement partner or the PricewaterhouseCoopers library at +27 (0) 11 797 5062.

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