

**THE IMPACT OF GLOBALIZATION
ON INTERNAL AUDITORS:
THE EVOLUTION OF INTERNAL AUDITING**

Prepared for

The Institute of Internal Auditors Research Foundation Board of Trustees

Administrators of

The Esther R. Sawyer Scholarship Award

March 1, 2002

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INTRODUCTION

The current business world is experiencing phenomenal changes. Business is simultaneously conducted in many lands and with many people, and markets are no longer restricted by boundaries or time zones. The current economic slowdown notwithstanding, the economic explosion generated by the new global economy demands attention and contemplation. Every aspect of the corporate world has been or will be affected by the limitless opportunities spawned by the novel, unfamiliar emerging markets that have accompanied global expansion. Internal auditing is no exception. Adaptation and proactive assimilation by the internal auditing profession must occur or else complacency and obsolescence will result.

The role and required skills of the internal auditor have been the subject of much recent discussion, particularly in the wake of the revision by the Institute of Internal Auditors (IIA) of its definition of internal auditing, which now states:

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.ⁱ

The IIA's leadership clearly perceives the imperative need for change in the new global economy, recognizing the need for internal auditors to add value by leveraging their strengths to fill their organizations' needs.

This paper will discuss the issues internal auditing faces as a result of the global economy that now permeates the economic environment in which we do business. The amorphous public market we currently conduct business in will drive internal auditing to evolve and adapt. However, forward-looking internal auditors will seek opportunities to proactively adapt to the business world's changing demands, rather than simply reacting to them. In order to achieve this evolution, six foci must be considered, as follows: Corporate Governance, Risk Management, E-

Business, Fraud, Outsourcing, and Recruiting. In this paper, my conclusions are derived from existing research used to evaluate how globalization has and will affect internal auditing.

FINDINGS

Corporate Governance

“Today ... internal auditors have the opportunity to be recognized as delivering value at the highest levels of their organizations by enhancing corporate governance.”ⁱⁱ Industries, markets, and competitors have become increasingly complex and diverse due to the expanded economy. Companies strive to find a competitive advantage amidst the menagerie of strategies that currently exist.

In a collaborative effort, The Institute of Internal Auditors Research Foundation and PricewaterhouseCoopers LLP recently conducted an exhaustive corporate governance study. The resulting findings were summarized and commented upon by Richard M. Steinberg and Deborah Pojunis. The study found that “corporate boards must embrace: strategy and planning; risk management, tone at the top; measuring and monitoring performance; transformational transactions; management evaluation, compensation, and succession planning; internal and external communication; and effective board dynamics.”ⁱⁱⁱ Steinberg and Pojunis concluded that internal auditors could create value in an organization by helping management carry out these responsibilities.^{iv}

Effective strategy is a matter of survival in the business world. A company can outperform its rivals only if a competitive advantage is found and maintained. “Competitive advantage is about being different. It means deliberately choosing a different set of activities to deliver a unique mix of value.”^v The internal auditors of a company can be a vital link in the

decision-making chain. “Internal auditing can help shape that information ... and provide crisp analysis in the areas of alternative strategies considered, risk factors, and performance measures. Internal auditing also can provide the board [of directors] analysis of best, worst, and most-likely case scenarios.”^{vi}

The recent events surrounding the collapse of Enron have put the importance of effective corporate governance in the spotlight. Issues such as off-balance sheet financing, executive’s compensation, and the use of derivatives are all being heavily discussed and evaluated by both corporate leaders and legislative bodies. Based upon impending corporate decisions and legislative rulings, the input and expertise of internal auditors could now be even more crucial in a company’s decision-making processes.

Critics of this concept argue that internal auditors who provide consulting services will lose their objectivity and blur the lines of auditor/auditee protocol, resulting in a distorted and tainted relationship. Actually, “consulting has been part of internal auditing for years, but it is just beginning to be considered a real service ... It is clear that internal auditors can add value to consulting assignments by providing the methodologies, facilitation, focus, knowledge, technology, best practices, and independence that help solve customers' problems.”^{vii} During an interview conducted by KPMG LLP, Dr. Glenn Sumners, DBA, head of Louisiana State University’s Center for Internal Auditing, said the following about the evolving role of the internal auditor:

Future audit emphasis will focus more on operations and strategies than it has in the past. Financial analysis remains important, but increasingly, the historical side of accounting is significant to the internal auditor only as it relates to future decision-making. That’s where internal audit adds value. So, internal auditors must be involved in organizational planning and strategy, especially at the operating and management level. They will determine how to identify the most significant business risks and exposures as well as identify missed opportunities.^{viii}

For example, internal auditors played a crucial role in the successful merger of NationsBank (now Bank of America) with Boatmen's Bank. "In partnership with management, internal audit helped the bank avoid consulting fees and unnecessary expenditures ... established programs to enhance customer retention; identified back-office inefficiencies and mitigated risks; helped management make sure that computer systems conversions would be seamless for customers, and facilitated the maintenance of normal operations during the merger."^{ix} The internal auditors helped consummate a complex merger by adapting and assuming more forward-thinking, managerial roles.

The possibilities available to internal auditing in our current global environment are boundless. Those involved in the internal audit function "must take a leadership role in assessing and managing risk, applying continuous quality initiatives, benchmarking and migrating best practices, and identifying opportunities. [They] must focus on value, by managing business and operational risks and identifying profit opportunities."^x Only then will internal auditors maximize the value they add to their organizations and aid in the maintenance of its competitive advantage at the highest levels.

Risk Management

Risk management is an area of paramount importance to an organization. Because every company is in business to take risks, effective risk management is necessary to the progression of a business entity—taking too little risk can be just as dangerous as taking too much risk.^{xi} The need for internal auditors to assist the management of a company’s risk has been discussed above. Further investigation into the roles internal auditors play is necessary to understand risk management issues created by globalization.

New risks exist that have not been contemplated. Globalization warrants a new internal audit model, and that model “must include a new element—one that focuses on the external risks and threats posed by globalization, new competition, changing technology, and mergers and acquisitions activity. That new element can infuse a powerful new risk focus into each of the historic segments, creating a new model for internal audit.”^{xii} Further analysis concludes the following:

This new vision calls for management to elevate internal audit’s focus to those critical business risks and exposures that determine an organization’s success or failure. It requires internal audit to understand those key business risks and how they enable or impede the organization in building shareholder value. This new vision requires internal audit to assess the risk responses that mitigate the key exposures as well as determine if those responses are sufficient or relevant.^{xiii}

Internal auditors need to facilitate the development of this new model, this new vision. As integral members of an organization, internal auditors have the position and ability to identify and prepare for previously unrealized global risks. “Given that risk is a moving target, it is only by keeping up with changing market conditions, regulations, technology, globalization and other industry trends and developments that risk can be comprehensively and successfully managed.”^{xiv}

In order to develop such a model, leaders need to ascertain their risks, whether operational or financial risks, decide what level of risk they will accept, and then assimilate those initial estimates within the internal audit function. “Using these conclusions, the internal auditor would analyze the key business processes in detail, focusing on those aspects of the operations that incur business risk and those where additional opportunities are likely to arise.”^{xv} The utilization of the internal audit function will help mitigate the global risks a company can be expected to face as it seeks out new, undeveloped markets.

Historically, risk has been evaluated using a two-part, or bipod analysis, focusing on the “cause” and “effect” of events. One professional suggests evaluating a third dimension, or tripod analysis—the third dimension being an assessment of how the activity is organized and performed, in addition to the cause and effect.^{xvi} By doing so, auditors can help simplify risk management and focus on how they truly add value: by improving the processes and performance of an activity. This professional furthers his conclusion by adding the following:

When auditors incorporate the third [dimension] into the audit process, they can evaluate the adequacy of internal control instead of focusing only on control or compliance. The tripod approach to auditing enables the auditor to respond clearly to client questions such as, "Why do we risk that?" or, "Can we do something?" Risk management becomes simpler and more straightforward for everyone involved in the process ... when auditors develop an audit plan, they are engaging in macro-risk assessment. At this stage, the auditors function at a strategic or conceptual level, and the bipod event and effect approach will likely be appropriate and relevant. When auditors perform an assignment, however, they must be more practical than conceptual, because they are close to the real world of operations. They're engaged in micro-risk assessment. It is at this point that risk must be perceived as a tripod: the possibility that an event or circumstance combined with a particular operational set-up will impede achievement of an organizational goal.^{xvii}

Using a three-dimension approach to identifying risk allows the auditor to clearly see that risk is a result of numerous factors, and that each must be identified and evaluated. Further, auditors will have the ability to recognize those risks that are predictable and/or controllable. An aptitude that enables an auditor to “think outside the box” concerning risk factors is necessary to

extinguish gaps that may form as a result of newly formed risks, those that may coexist within the venture. “The auditor must be on the alert for something that is not done, not checked, not monitored; or points where there is no control to ensure that the activity is well performed.”^{xviii}

“Good business is all about risk; business growth cannot occur without introducing new risks; business objectives cannot be achieved without placing assets at risk; and business rivalries cannot be won without ‘out-risk-taking’ the competition.”^{xix} Such risk taking is evidently necessary for businesses in a globally competitive market. Internal auditors must be equally ready to mitigate the risks that their organizations need to undertake in order to endure.

E-Business

Business seems to be moving at light speed. Technologies exist that could only once be imagined. With these added technologies come added opportunities and added challenges for internal auditors. “The dramatic evolution of technology's role in the marketplace is impacting internal auditors, because new skills and knowledge are necessary to ensure that electronic transactions and the resulting growth occur in a controlled environment. E-business is one of the most common and complex new business solutions, and there are many issues of which internal auditors should be aware when reviewing such applications.”^{xx}

In the last few years, we have seen the rise of computer networking and software giants. One such company, Cisco Systems Inc., was once one of the most admired companies in the world, only to see its revenues, profits, and market value plummet in recent months. Technology has dramatically accelerated the rate of change, and many organizations are struggling to keep up.^{xxi} Confusion and change have replaced comfort and composure in the midst of corporate decisions. Auditors, according to one professional, can personally help organizations in the following ways:

Internal auditors can thrive in the midst of this confusion and, in fact, are needed more than ever before. As our organizations sail to the new world of e-business, auditors can be at their side. We can provide necessary advice and counsel as our clients embark on new explorations. In fact, the recently updated definition of our profession emphasizes the auditor's role as a consultant and risk manager. In this capacity, we can help identify and assess new business risks so that management can make wiser decisions. If necessary, we can shout a warning when we see icebergs ahead.^{xxii}

The innovative ways that business can be conducted will likely present considerable-sized “icebergs” to all global corporations trying to thrive in an e-business environment. Great opportunities exist for those individuals who are willing to learn, adapt, and implement technological advances in their auditing functions. “Auditors must embrace change or risk going the way of the dinosaur. We will survive and thrive if we can reinvent our work.”^{xxiii}

In May 2000, Andersen LLP conducted a survey detailing the current internal audit functions of over 60 companies in the United Kingdom. Andersen found that “the largest single technology issue faced by 70% of the companies surveyed is perceived to be the significant increase in e-business activities. On average respondents believe that the level of activity has increased by 81% in the last three years and will increase from this much larger base by a further 52% over the next three.”^{xxiv}

Companies facing these technology challenges will need internal auditors to be on the forefront of the issues. In some cases, traditional financial auditors may find the need to metamorphose themselves into information technology (IT) auditors in order to handle the increased technical demands. “E-business will continue to be a necessary business tool, and highly specialized and developed IT skills will be required to assess the systems associated with it. A fundamental understanding of IT systems will allow traditional auditors to work in e-business environments.”^{xxv}

According to Robert Simons, author of Performance Measurements & Control Systems for Implementing Strategy, three risk exposures exist that can affect e-business: growth, culture, and information management.^{xxvi}

1. Companies dealing in e-business usually have inordinate expectations of growth surrounding their organization. Such pressure is evidenced by the punishment received from the stock market when companies do not meet their revenue growth targets. Technology giants Cisco Corp., Nortel Networks, Oracle Corp., Sun Microsystems, Intel Corp., and many others feel the brutal reaction from investors when expectations aren't met.^{xxvii}
2. The culture a company cultivates may incite certain risk factors; such culture has been called a company's risk appetite. "Risk appetite is traditionally associated with the use of economic capital or funds that an organization is prepared to release in exchange for a greater return. Risk appetite is acquired over time and manifests itself in an organization's visions and values, corporate culture and strategy, regulatory compliance, [and] past experiences."^{xxviii}
3. How a company deals with its information greatly affects the accompanying risk. "In an ever-changing business environment, it is paramount that an effective communication system exists within a company to keep everyone abreast of the latest changes and the impact they may have on the operation of the company."^{xxix}

These three risk exposures exacerbate the problems internal auditors face in the new, global economy. As mentioned previously, new strategies must be developed to accommodate the revolutionary changes that are becoming commonplace in our current business environment. "At a minimum, the review of an e-commerce application should examine the process used for

selecting and justifying the e-commerce system, customer service levels, security, Web page maintenance and monitoring, Web promotion, and risk analysis.”^{xxx} Today, virtually every aspect of business is technology driven, and to assess business processes, auditors need to be versed in and prepared to apply technology fundamentals.

Fraud

Globalization has opened the floodgates for fraud opportunities. With the advent of e-business and the traversing of companies across uncharted territories, the vulnerability of companies to fraud have never been more prevalent. “Controls and audit usually lag behind changes in systems and operations. Decentralizing, going global, outsourcing of manufacturing and services, strategic alliances, and selling on the Internet can provide real value, but they also provide new opportunities for fraud.”^{xxxi}

According to a recent survey by the San Francisco-based Computer Security Institute (CSI) and the U.S. Federal Bureau of Investigation Reports, computer-security breaches cost each affected U.S. companies an average of more than \$2 million per year. In addition, the 2001 Computer Crime and Security Survey reveals that the threat of computer-related crime and other online security intrusions continues unabated and that the financial toll of these attacks is mounting.^{xxxii} Another survey that polled 538 computer-security professionals in corporations, governmental agencies, medical institutions, universities, and financial institutions, reveals that 85 percent of respondents detected a computer security breach in the past six months. Moreover, 64 percent of these respondents indicate that they suffered financial losses as a result of the breaches. The 186 respondents who disclosed the amount of financial damage they suffered reported an aggregate total of \$377,828,700 in losses.^{xxxiii}

Again, internal auditors will need to respond to the new challenges facing expanding companies. “Specialized resources are needed in the areas of information technology and security, ... forensics and other operational areas of the business.”^{xxxiv} Additionally, a pressing need exists for organizations to establish a system for handling these imminent problems. “Organizations that want to survive in the coming years need to develop a comprehensive approach to information security, embracing both the human and technical dimensions ... they also need to properly fund, train, staff, and empower those tasked with enterprise-wide information security.”^{xxxv}

The proliferation of Internet transactions has made fraud prevention and detection much more daunting for internal auditors. Several proactive approaches auditors can take to help mitigate the growing risks to organizations have been suggested. The following general guidelines can help serve as internal auditors seek to help control this runaway crisis.^{xxxvi}

- *Develop new internal controls that are as effective as those that used to exist in a paper environment.* Internal auditors need to personally be involved in the creation of controls to handle various e-business variables and scenarios.
- *Become a bridge-builder between IT and senior management.* Auditors must interact regularly with the people in charge of IT; this will enable auditors to address emerging issues with senior management.
- *Encourage sharing of information.* Auditors need to work with, or at least be aware of, national and international organizations that are exchanging information about how to fight cyber-crime. Hackers and crackers are continually working their information networks attempting to accumulate sensitive information. Internal auditors should equal this effort in attempting to thwart deviant, criminal activities.^{xxxvii}

Today, more than ever, “many internal auditors have to act as cyber-crime scene investigators participating in the field of forensic technology.”^{xxxviii}

Outsourcing

“Outsourcing is a phenomenon that is sweeping across many organizations and many different functions within organizations.”^{xxxix} The outsourcing of organizational functions has taken place for a number of years. Recently, though, it has begun to garner attention from some of the world’s largest companies. For example, many *Fortune* 500 companies including McDonald’s, Whirlpool, Time Warner and PNC Bank have adopted an integrated audit approach by outsourcing their internal audit function.^{xl} In some cases “this approach has been very successful in terms of maximizing the company’s return on its total investment in audit services.”^{xli}

One of the main arguments for outsourcing is the need to increase value without increasing costs. Currently, business is run at a rapid pace. Companies cannot afford to be complacent or lackadaisical; all units of an organization must provide value. From this vantage point, companies are seeking to find ways to increase output without increasing costs, and outsourcing provides an avenue of choice. Conversely, opponents of this theory do not see the outsourcing of crucial functions, such as the internal audit function, as anything but detrimental to an organization.

Arguments exist that support the outsourcing of the internal audit function; four of these arguments are as follows:

- *Outsourcing allows management to focus on core competencies.*^{xlii} If management is allowed the time to formulate strategy and develop the company’s core competencies, an organization will be better positioned for global expansion.

- *Economies of scale should result in cost savings for the same services, or improved services for the same costs.*^{xliii} Optimally, by exploiting another company's expertise, an organization can maximize its total investment in audit services by increasing the areas of risk coverage while decreasing the amount of audit overlap and redundancy (thus reducing costs).
- *Access to leading practices.*^{xliiv} The outside provider can furnish insight, benchmarking, and best practices seen and performed by other companies.
- *Better international and cultural coverage.*^{xlv} Large international public accounting firms have locations that span the globe. The utilization of existing contacts and resources can provide a competitive advantage.

In opposition to the above points, arguments do exist against outsourcing; four of these arguments are as follows:

- *Over time, outsourcing providers will command an ever-greater premium for their services.*^{xlvi} As dependency increases, the outsider provider will be able to increase the price paid for their services. This trend could ultimately negate any cost savings previously enjoyed.
- *An external provider will not know the businesses as well as insiders do.*^{xlvii} Outside firms refute this argument claiming that a broader background in multiple companies is a much greater advantage. Regardless, an insider would definitely know the intricate operations of his or her own organization more intimately.
- *A valuable training ground is lost.*^{xlviii} "Internal auditing is a job where ambitious employees can learn about all parts of the company as they study ways to make the

organization operate more effectively.”^{xlix} Internal auditing can be a stepping-stone for future managers.

- *Workforce morale will be seriously impaired.*¹ Layoffs or decreased job growth opportunities that may result from a downsizing of operations will only lead to reduced morale and anxiety about job security, which in turn will affect work productivity. Thus, the layoff threat could hamper the desired efficiency management was seeking.

Additional arguments also include that the allegiance of the employee will be to the outsourcing provider, not the client, and that the essential benefits of corporate governance cannot be outsourced.^{li}

Unfortunately, there are no easy answers to the outsourcing phenomenon. The one reality is that the outsourcing of the internal audit function is an option for a global company seeking to increase market share, efficiency, and ultimately profitability. Intuitively, an organization could also increase market share, efficiency, etc. without compromising the integrity of a company’s internal audit structure and function. The key is for an organization to identify these various options and exploit those that result in the most effective and efficient outcomes. For example, a current trend is toward “co-sourcing,” where a company keeps its internal audit function, but works with an outside firm to supplement the in-house function with added manpower and expertise when and where needed.

Recruiting

In today’s global economy, the spotlight seems to be focused on either external auditors providing assurance to financial statements, investment bankers who underwrite initial public offerings, or information technology specialists who build and design intricate systems. Current market conditions, technological advances, and new opportunities are providing college

graduates with plentiful options for employment. Rarely are internal auditors highlighted in news articles or features, or even listed in guidance counselor's manuals. Because of the relative anonymity that seems to be affecting internal auditors, steps must be taken to ensure that a healthy influx of recruits into internal auditing occurs.

Many things can be done to make internal auditing more marketable to students. One suggestion is to focus on IT advances in the internal audit department. "Internal audit departments need to market themselves effectively to IT professionals if they are to meet their recruitment targets. This will involve creating a strong selling message given the vast number of opportunities currently available for IT professionals."^{liii} Another is to start at the education level, thereby influencing class choice and ultimately choice of profession. "To ensure internal auditing remains a viable profession, we must appeal to the next generation of potential auditors. Getting involved at the educational level will not only help perpetuate the profession, but it will also ensure that internal auditing continues to evolve and grow."^{liiii}

A recent survey^{liv} given to the upper division accounting classes (approximately 75 percent of the respondents were senior accounting majors) of seven universities provided evidence that internal auditing has much to do in order to rise out of its relative obscurity. According to the findings, all of the students were familiar with the CPA designation, but a substantially fewer number were familiar with the CIA designation. When asked to rank the relative importance of the three most prominent certifications (CPA, CMA, CIA), CPA was first, CMA was second, and CIA was last. In total, only 3 percent of the respondents claimed to be interested in internal auditing as a career.^{lv} Another poll found that "of 50 institutions with accounting programs, only 11 out of 50 (22%) indicated that they offered an internal auditing course to accounting majors."^{lvi}

Clearly, internal auditing has a long road to travel to take its proper place with the upper echelon of accounting designations and certifications. As mentioned previously, the emergence of global markets creates a predicament for recruiting. With the vast portfolio of choices now available to college graduates, efforts must be increased to attract the best and brightest into the internal auditing profession.

Some professionals suggest increasing recruiting by advertising internal auditing as a training ground for future corporate managers and leaders. “Using the internal audit department as a training ground for the organization’s future finance and corporate leaders is a strategy employed successfully by a variety of leading-edge companies. This approach moves internal audit away from the role of detective and closer to a partnership with management—one devoted to real-world problem solving focused on determining the strategic direction of the business.”^{lvii} Returning again to Dr. Glenn Sumners, head of Louisiana State University’s Center for Internal Auditing, he believes “high turnover is inseparable from the new vision of internal auditing, which emphasizes evaluating processes over enforcing controls. There can't be a better place to put your bright people than in internal auditing ... leave them there two or three years, and then rotate them out. They'll get the big picture, they'll have a business orientation.”^{lviii}

As shown throughout this paper, the opportunities for internal auditors are greater now than they ever have been. Whether it is in corporate governance, risk management, e-business, fraud detection and prevention, or even doing outsourcing work, the options available to internal auditors are many. Ultimately, these tremendous opportunities in themselves represent a singular opportunity to attract bright, capable new internal auditors into the profession.

CONCLUSION

The time for internal auditing to adapt and assimilate, grow and evolve is now. The combination of natural growth through acquisitions and mergers, as well as the expansion resulting from globalization, has provided catalytic opportunities for the internal auditing profession. As initially stated, the IIA clearly recognized the changes needed when they broadened the definition of internal auditing to encompass the necessities of a changing, global business environment.

Internal auditors will be able to adequately respond to this transitional and shifting time by focusing their efforts upon six main areas: Corporate Governance, Risk Management, E-Business, Fraud, Outsourcing, and Recruiting.

“As technology has evolved in recent years, erasing global barriers, companies worldwide have dramatically transformed their operations. The transaction-based audit approach that evolved during the industrial age is not suited to the information age, when inventory arrives just in time, processes have value, and property is often intellectual.”^{lix} Now is the time for internal auditing to respond to these new challenges and opportunities. No greater time—nor a more crucial time—exists.

ENDNOTES

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