



Escalating the role of internal audit

Ernst & Young's 2008 Global Internal
Audit Survey



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From compliance to business improvement – the transformation of internal audit

The internal audit landscape continues to progress – offering internal audit a more strategic role in the organization by focusing its efforts on business and process improvement. Risk and growth remain a priority for executives and audit committees in today's unstable business climate.

Risk is an important aspect of any business operation. Without taking business risks, growth and profit would be almost impossible. It permeates all of the fundamental business challenges companies face, from recruiting the best people to managing the business' finance. However, the best companies are not those that avoid risk, but rather those that understand and control the risks they are taking. Audit committee's and executive management's expectations around risk management are changing as they continue to confront the growing uncertainty of today's turbulent markets. As a result, internal audit functions are being asked to raise their game and deliver increased value to the

organization by covering the risks that matter. This means covering not only compliance and financial risks, but expanding focus to include strategic and operational risk areas.

Ernst & Young's 2008 *Global Internal Audit Survey* examines the evolving role of today's internal audit function and how chief audit executives are meeting the heightened expectations of stakeholders. The results of this survey highlight the progress being made as companies transform their internal audit functions to become more strategically relevant, with specific focus on three categories: governance, people, and infrastructure and operations.

Key findings:

- ▶ The audit committee and executive management continue to look to internal audit for balanced focus between compliance and business improvement. However, business improvement has taken on more prominence over the last two years and this trend will continue given the challenging market conditions.
- ▶ Concentration on internal controls over financial reporting has resulted in competencies within internal audit that do not fully meet the needs of the organization. This is now impacting the effectiveness of the risk assessment process, internal audit plan development and quality and coverage of internal audits.
- ▶ Risk assessment is considered a necessary competency of internal audit and is becoming more focused on the relevance to the organization, with increased coverage of strategic and operational risks. Additionally, internal audit is expanding the risk assessment process to cover broader industry risks and obtaining input from company risk management functions and external sources.
- ▶ Internal audit functions are retooling the competency of their staff as the focus shifts from compliance to business improvement. Retention and competency development of top-performing internal audit talent continue to be key issues to both internal audit and the organization.
- ▶ With the audit committee's and management's increasing demands from internal audit, quality continues to grow in importance. As a result, embedding and measuring quality in all aspects of internal audit – governance, people, infrastructure and operations – are also increasing in importance.
- ▶ Investments in, and use of, technology and knowledge are continuing indicators of highly effective internal audit functions.

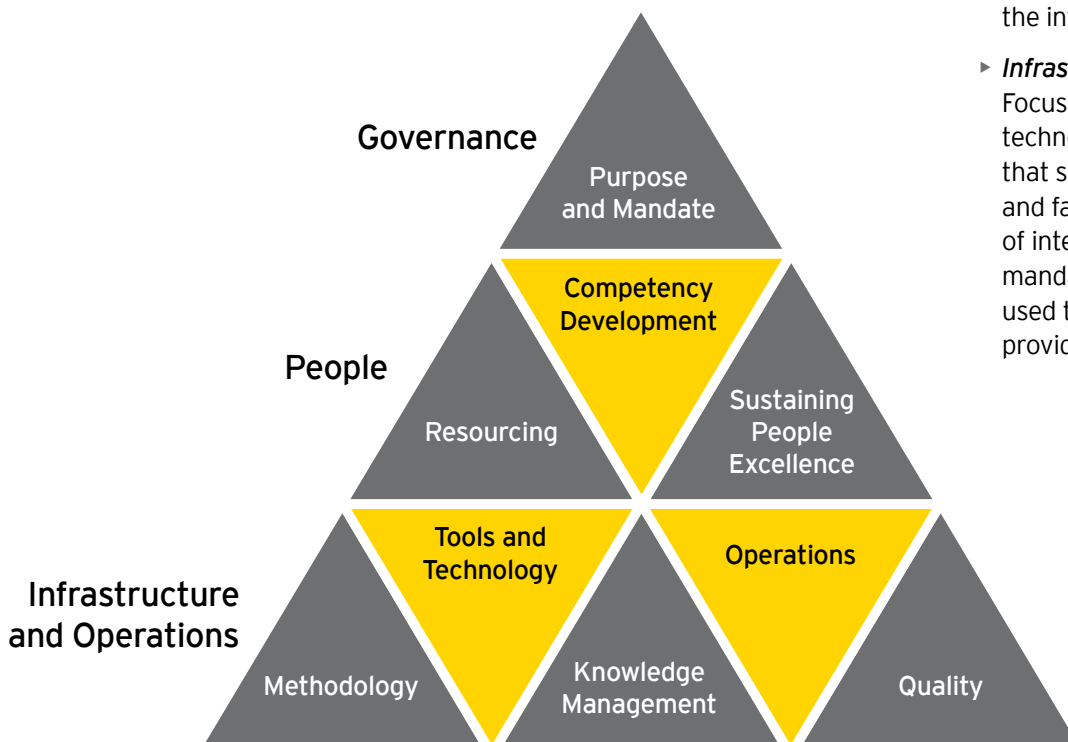
About the survey and its organization

This report highlights the main findings from our 2008 survey of internal audit executives representing 348 companies. The majority of the participants' companies were large multinational operations with revenues over US\$5 billion. Twenty-five percent of the respondents are members of the *Fortune* Global 500 and 49% are members of the *Forbes* Global 2000. The survey had broad geographic coverage, with executives from 35 countries and 23 industries taking part.

Internal audit framework

To help structure the survey results, we used Ernst & Young's internal audit framework, which has been used by approximately 200 leading companies to analyze their internal audit function. The **2008 Global Internal Audit Survey** results are aligned with this framework, providing focused insight related to internal audit governance, people, and infrastructure and operations:

- ▶ **Governance** – Focuses on the role and mandate of the internal audit function and its relationship with key stakeholders.
- ▶ **People** – Focuses on the structure and processes to recognize, hire, retain and develop the competency of the internal audit staff.
- ▶ **Infrastructure and Operations** – Focuses on the methodologies, technologies and quality programs that support internal audit activities, and facilitate the achievement of internal audit objectives and mandate, as well as the practices used to execute internal audits and provide service.



The decreased focus on compliance-related processes provides an opportunity for internal audit functions to increase their involvement in enterprise risk management efforts for the organization.

Governance

The role of internal audit continues to evolve

Both audit committees and management expect the internal audit function to provide traditional monitoring activity around key risks and controls, assessment and reporting of internal control deficiencies, and monitoring the resolution of identified deficiencies. However, the role of internal audit is evolving beyond its primary focus on compliance activities to a more consultative role. Increasingly, audit committees are seeking internal audit's participation in discussions regarding process improvement recommendations, emerging risks and trends and risks in the business (including insights around risk appetite and tolerance levels) other than those already included in the internal audit plan.

Risk and control activities, now more deeply embedded within the operational and business units of the company as a result of internal control regulations [e.g., The Sarbanes-Oxley Act of 2002 (SOX) and Japan's Financial Instruments and Exchange Law (J-SOX)], have allowed internal audit to realign resources for a more balanced focus on both compliance and advisory. This, in turn, better positions internal audit as a strategic player in risk management and increases the value delivered through the execution of the internal audit plan.



Compliance and financial reporting efforts decrease

The assessment programs for internal control over financial reporting (ICOFR) is maturing for most companies. As such, the role of internal audit is transitioning to the monitoring of high-risk and operational areas to better support management and business process owners. Only 12% of respondents (compared with 36% of respondents in our 2007 survey) stated that internal audit will have full ownership for ICOFR assessment programs (e.g., SOX) going forward.

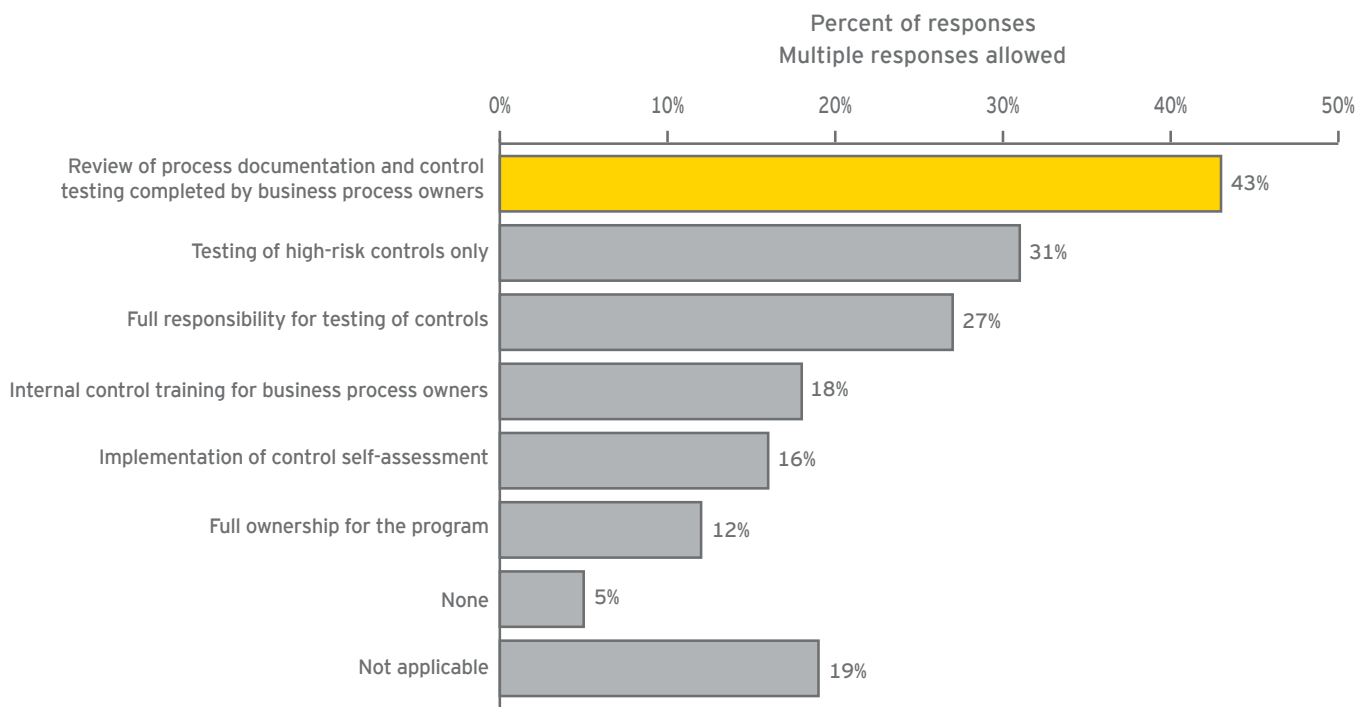
In the future, internal audit's role in helping organizations comply with ICOFR regulations is expected to concentrate on reviewing process documentation and control testing completed by business process owners and on the testing of high-risk controls and processes. This expected change in internal audit's role provides the opportunity to redirect resources to areas that are strategic to the company and less compliance related.

Continued interest in operational risks and improvement

Given internal audit's changing role, respondents indicated that, over the next one to two years, more time and resources will be allocated to cover the company's key business risks. Fifty-four percent of respondents indicated more involvement in information technology (IT), 53% in major capital programs, 45% in business process improvement and 44% in information security.

The challenge many companies face is the ability to align coverage of the company's key business risks with existing internal audit competencies. Many respondents indicated their internal audit function had limited or no current involvement in some of these strategic and operational risk areas. To increase effectiveness, internal audit must retool existing resources and add new resources/skills to provide coverage of these high-risk areas.

Going forward, what role will internal audit play in helping the organization comply with the internal control regulations (including SOX)?





Risk assessment is no longer just a leading practice

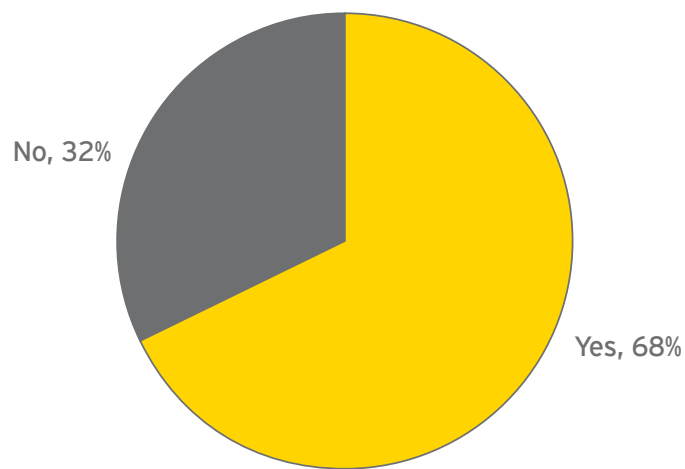
Risk assessment is considered to be a critical competency of internal audit and is becoming more focused on relevance to the business with coverage of high-risk areas across the organization. Surprisingly, one-third of respondents indicate that a risk assessment is not being performed organization-wide, even though audit committees and management see the importance of assessing key organizational risks. In about half of the companies surveyed, the internal audit function does play a prominent or lead role in the company's enterprise-wide risk assessment activities. Conversely, roughly half of respondents indicate that internal audit currently has limited or no involvement.

The ability to provide enterprise-wide risk coverage through effective risk assessment processes is directly affected by the level and experience of resources used by the internal audit function. The lack of resources with relevant subject matter experience, industry knowledge, leading business practices and tools and technology all

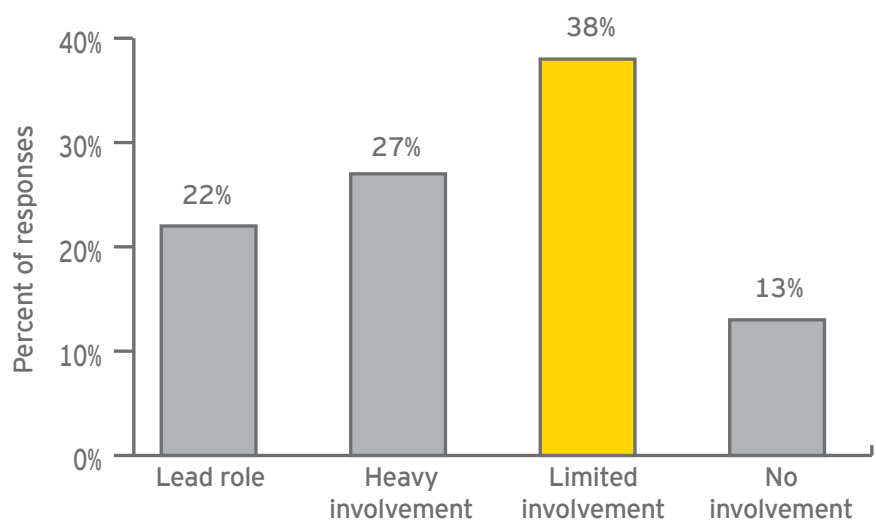
stand as major hurdles to conducting an effective risk assessment. Only 17% of respondents rated their risk assessment performance as "very competent." For internal audit to effectively conduct an enterprise risk assessment, the function will have to develop or secure the necessary competencies in its staff mix. Investments in targeted skills will provide the competencies necessary for conducting effective risk assessments and provide the level of risk coverage desired by the audit committee and management.

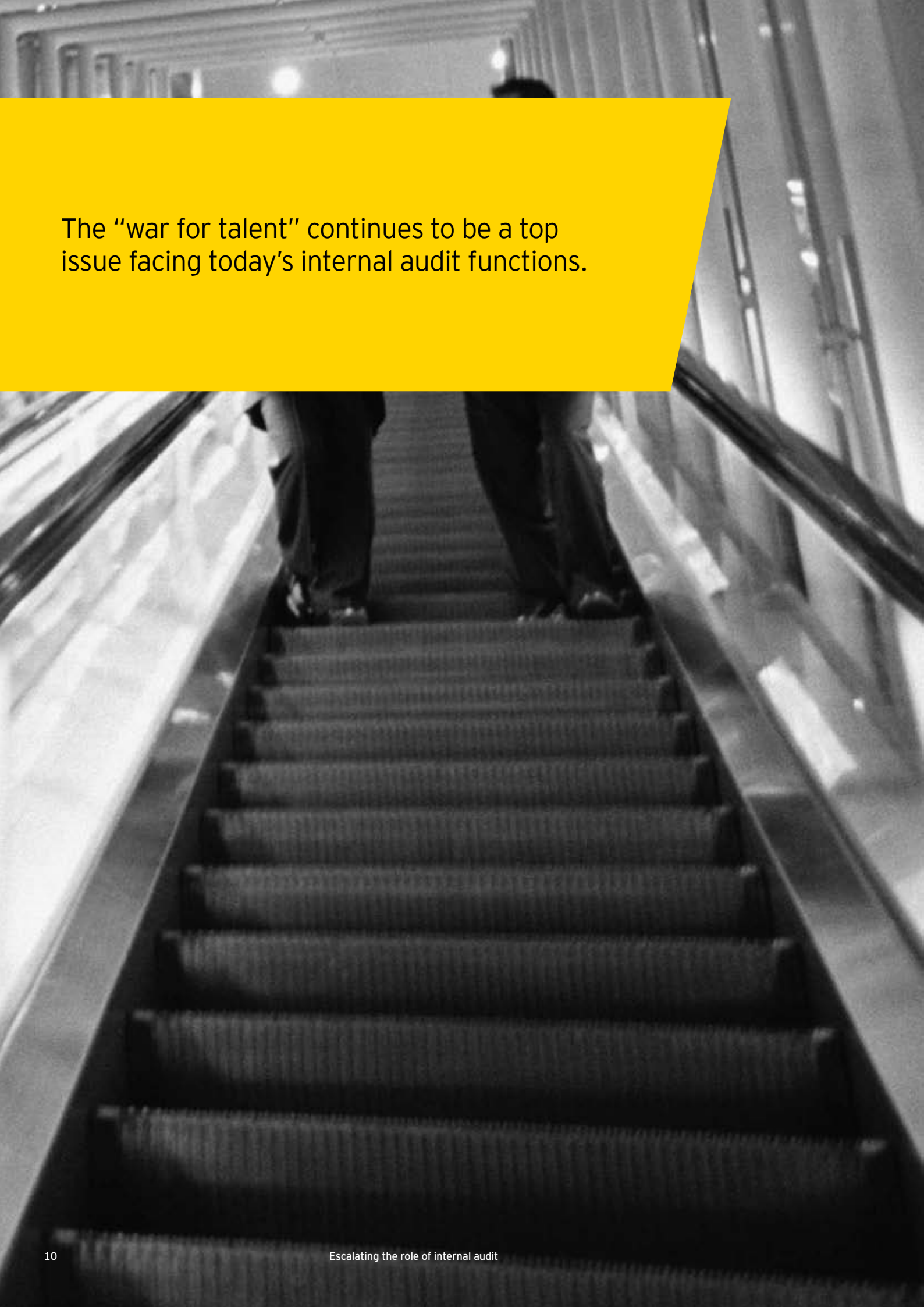
Nearly half of the companies surveyed have formal enterprise risk management functions and most have multiple risk management functions in addition to internal audit. The survey results indicate little integration of the risk assessment processes among these functions, suggesting significant opportunity for improved alignment. Only 20% reported the risk assessment activities conducted across the organization are well aligned, with 19% reporting no alignment at all.

Is an enterprise risk assessment performed across the organization?



What is internal audit's involvement in the enterprise risk assessment activity?





The “war for talent” continues to be a top issue facing today’s internal audit functions.

People

Challenges in retaining the best talent

Many organizations struggle to retain high-performing talent. When asked to estimate the annual personnel turnover within the internal audit function, almost one in five respondents indicated a turnover rate in excess of 20%. Thirty-four percent of respondents reported an estimated annual staff turnover rate of more than 15%.

While there are many factors that contribute to the successful retention of high-performing talent, competitive compensation was considered to be the most important factor. This was followed closely by an opportunity for challenging and diverse assignments, and recognizing and rewarding performance.

Other factors noted in the survey include: maintaining work-life balance, providing continuing learning and skills development and opportunities to rotate into other positions within the business. Additionally, 71% of respondents do not have a formal program to rotate business professionals through internal audit. Of the 29% that do, the length of time spent in the internal audit rotation program is typically between two and three years.

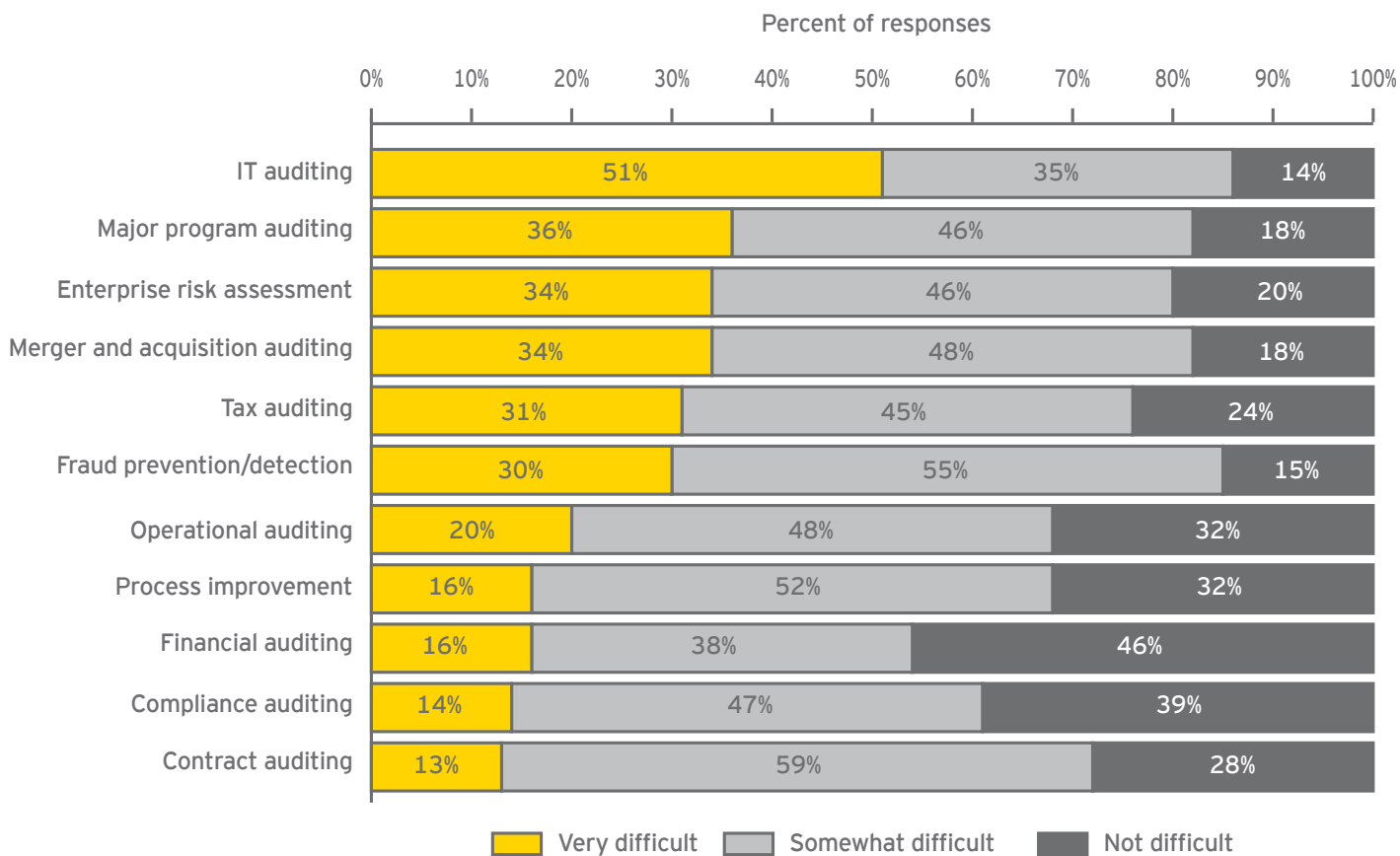


Trends in personnel movement – specialty skills are in high demand

In continuing to adapt internal audit to remain relevant to the organization, there is an ever-increasing demand for specialty skills to meet the changing risk profile. To address this gap, leading organizations are transforming their internal audit function in a variety of ways: retooling existing resources, rotating personnel from within the business and leveraging third-party relationships. The needs within internal audit are acute enough, but further pressure is placed on those organizations that look to internal audit as a conduit for leadership talent.

The survey found that only 69% of the respondents are at 90% or more of their budgeted headcount. While some of this resource shortfall is being driven by an increase in staff size over the past 12 months, the “war for talent” continues to be a top issue facing many internal audit departments, with specialty skills such as IT, capital program, risk assessment, mergers and acquisitions and fraud being the most difficult to recruit. Eighty-three percent of respondents are using third-party providers to help fill these specialized skill gaps, as well as to provide coverage for staff shortages and international locations.

In today's market, what skill sets do you find most difficult to recruit?





International coverage remains a challenge

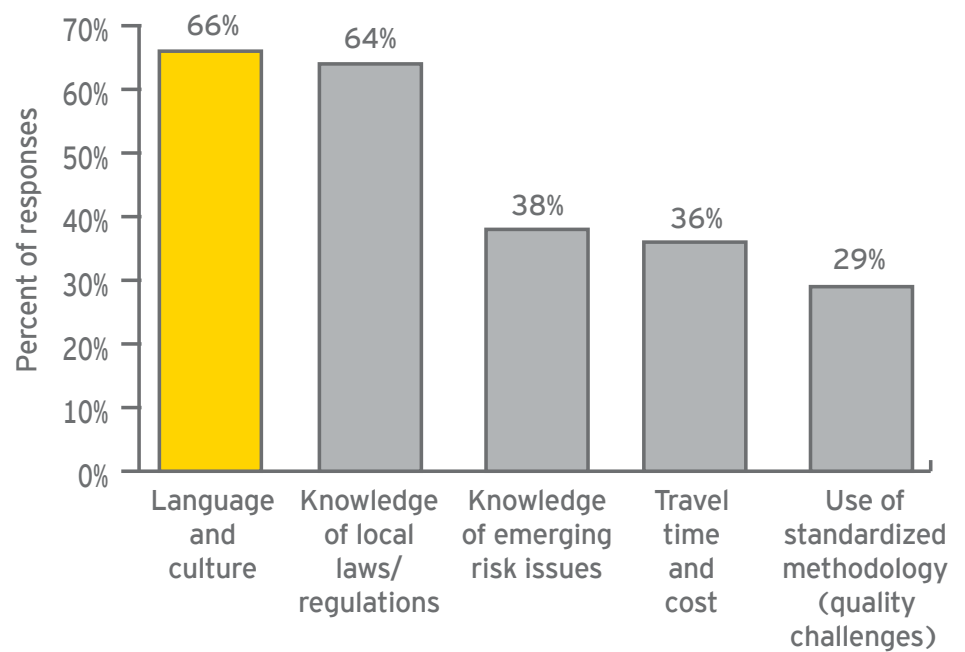
As companies continue to expand beyond their local borders, they require more advanced governance and control processes to deal with the complexities of operating in the global marketplace. But, despite the higher risk involved in international operations, particularly in emerging markets, internal audit functions are struggling to provide sufficient resources and effective coverage of these operations. The survey identified that the majority of respondents continue to be less than “highly satisfied” with risk coverage by internal audit in international locations. The challenges to the provision of effective coverage are both cultural

and technical. They include differences in language and culture, knowledge of local laws, regulations, knowledge of emerging risk issues, a reluctance of internal audit staff to travel and overall travel costs.

The percentage of internal audit functions providing international coverage from a central location, with limited competencies to address these challenges, continues to be higher than otherwise expected. Thirty-eight percent of respondents provide coverage of international operations from a central location, 21% through local teams and 19% with the assistance of third-party providers.

What are the major challenges in conducting audits for international operations?

Multiple responses allowed





Increased focus on people development

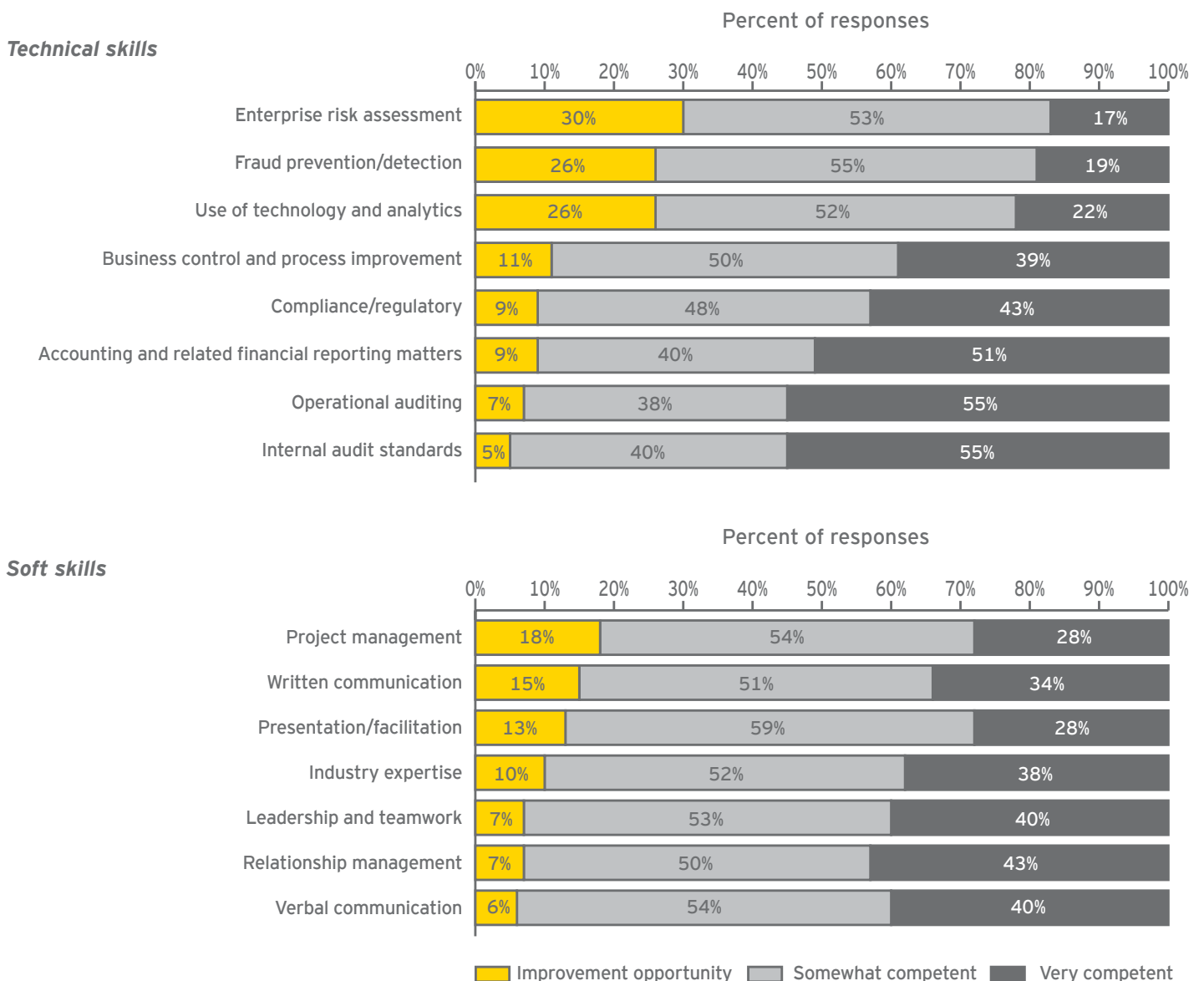
With the increasing expectations of the audit committee and management, investing in relevant skills development becomes a prerequisite for meeting growing stakeholder needs. Not only is specialty skills development important, but so are the core skills around conducting risk assessments, performing internal audits, evaluating processes and identifying business improvement opportunities. The survey results indicate that competency development needs greater focus. According to the survey, 55% of respondents view lack of time as the key impediment to training efforts. The majority of respondents require less than 40 hours of training annually and 43% report that less than 90% of staff met their training requirements during the last year.

The survey also noted the following:

- ▶ The technical skills that have the highest improvement opportunity include enterprise risk assessment, fraud prevention/detection and the use of technology and analytics.
- ▶ Soft skills gaps are largest for competencies related to project management, presentations, facilitation and written communication proficiency.
- ▶ Thirty-three percent of all respondents do not have formal competency models while only 45% of the respondents have learning maps by individual.

As companies rebalance their efforts between financial compliance and business and operational risk, internal audit functions are being challenged with development of the specialized skills necessary to meet the expanding expectations of stakeholders.

How would you rate your current team's competency in the following technical and soft skills?



Leading companies periodically refresh their risk assessments and update the internal audit plan throughout the year to address the impact an ever-changing business environment has on the risk profile of the organization.



Infrastructure and Operations

Developing and completing a risk-based internal audit plan

Today's dynamic business environment creates the potential for new risks or increased exposure from existing risks to arise throughout the year. As a result, leading internal audit functions are refreshing the risk assessment and internal audit plan semi-annually, or more often.

In order to recognize and adapt to critical changes in the business environment, some internal audit functions are shortening their planning horizons (e.g., quarterly) to reduce the need for excessive internal audit plan changes early in the plan year. The remainder of the year is treated as a projected outlook that can be adapted to incorporate changes during development of the next quarterly segment:

- ▶ Only 30% of respondents fully completed their internal audit plan last year. In addition, 19% indicated that their current budget and headcount are insufficient to meet the expectations of the audit committee and management.
- ▶ When asked to identify the main challenges in completing the internal audit plan, 84% indicated the assignment of resources to unplanned projects, 70% identified time and project management, 66% specified headcount not being at budgeted levels and 53% reported a lack of specialty skills.
- ▶ Forty-eight percent of respondents update the internal audit plan annually, while 19% update their plan semi-annually, 20% quarterly, and 13% more frequently than quarterly.
- ▶ 2 out of 10 companies that update their risk assessment annually do not update their internal audit plan.



Increasing focus on specialty risk areas

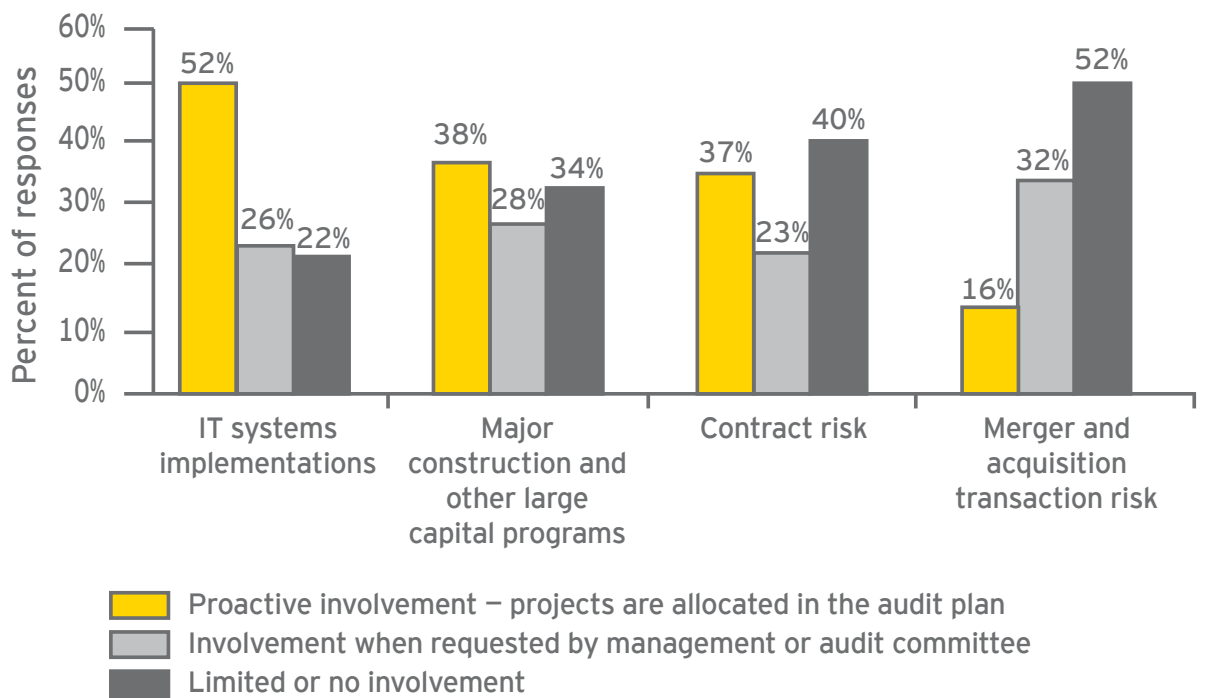
Coverage of specialty risk areas is a growing trend that is largely being driven by expanding audit committee and management expectations.

Internal audit has an opportunity to provide additional value to the organization by increasing coverage of specialty risks that help improve the business overall. In addition to internal audit, companies use multiple risk management functions to help manage the complex risks they face in their unique business environments. Though many of these may fall outside the competency of the internal audit function, internal audit can play a role by evaluating and monitoring the effectiveness of the various risk functions in managing and providing timely reporting of these risks to the audit committee and management.

When asked to what extent specialty risk areas are included in the internal audit plan:

- ▶ Fifty-two percent of respondents proactively include IT system implementation reviews in the internal audit plan, while 22% conduct limited reviews or have no involvement in IT system implementations.
- ▶ Thirty-eight percent of respondents proactively include major capital program reviews in the internal audit plan. However, 34% conduct limited reviews or have no involvement at all.
- ▶ Only 16% of respondents include merger and acquisition transaction reviews as part of the internal audit plan. Fifty-two percent conduct limited reviews or have no involvement in mergers and acquisitions.
- ▶ Thirty-seven percent of respondents include contract risk in the internal audit plan with 40% providing limited or no monitoring reviews.
- ▶ When asked why there was limited review or no involvement by internal audit in each of these specialty risk areas, respondents consistently indicated their reliance on other risk management functions to provide coverage.

What is internal audit's role in the following specialty risk areas?





Continuous auditing gaining momentum

Investments in technology and the skill sets to perform continuous auditing should allow many internal audit functions to reap additional benefits to address both the breadth and depth of risks throughout the organization. Our survey shows that 42% of respondents have already implemented a continuous auditing program. Most have done so to identify control deficiencies, monitor risks and identify potential fraud activities. Of the 58% of respondents that have not yet implemented a continuous auditing program, more than half indicate there are plans for implementation in the future. Reasons for not having already implemented a continuous auditing program include the lack of skill sets within internal audit, budget constraints and no perceived value in the program.

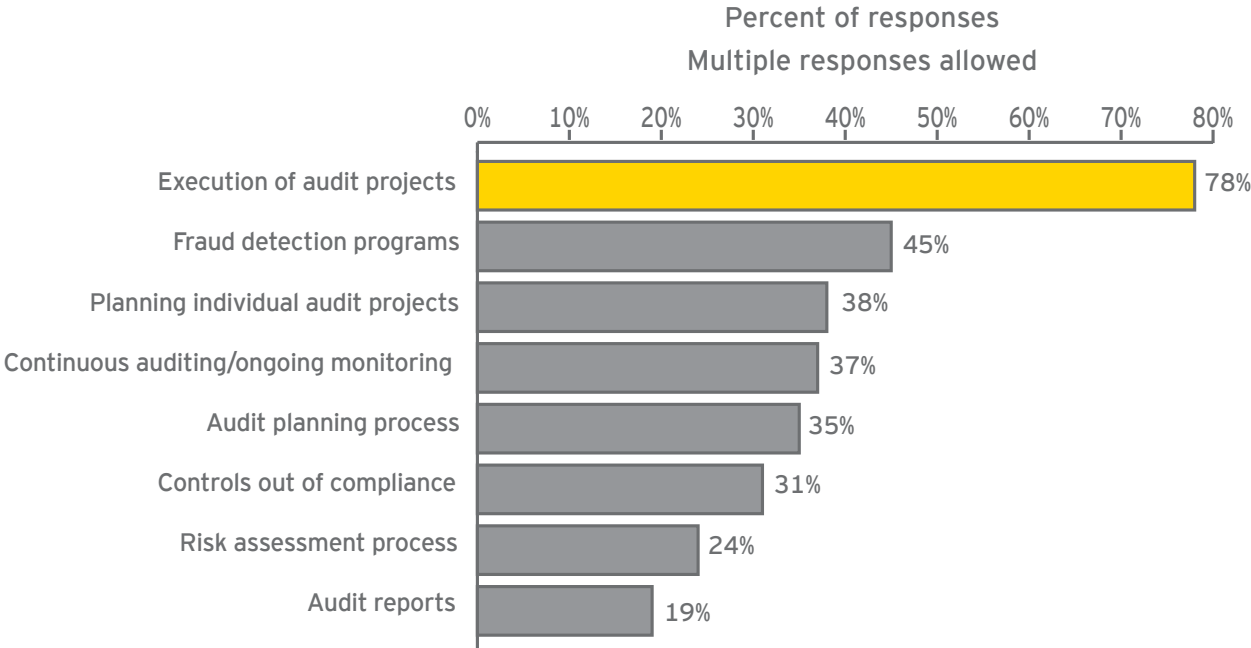
Use of data analytics

While the vast majority of internal audit functions have data analytics tools, few have the skill sets and capabilities to utilize them in a way that improves their business and addresses the changing risk profile. Leading internal audit functions use data analytics for numerous activities, including risk assessment, planning, execution and reporting. In addition, data analytics techniques, such as predictive modeling, regression analysis and data mining, have been successfully used by internal audit functions for fraud detection, testing of controls and root-cause analyses:

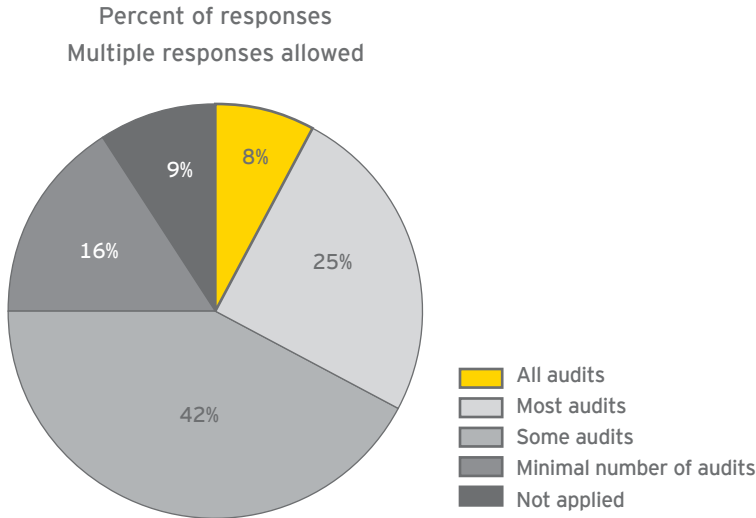
- ▶ Eighty-three percent of respondents indicated that data analytics is used by their internal audit function. These respondents use data analytics primarily in audit execution of projects, fraud detection programs and in planning individual audit projects.
- ▶ A majority of the respondents indicated that 40% or less of their internal audit staff is proficient in the use of data analytics.
- ▶ Only 8% of respondents indicated data analytics are not leveraged on **all** audits.
- ▶ Only 25% of respondents indicated data analytics are leveraged on **most** audits.


Given the appropriate business objectives, budget, skill sets and executive sponsorship, continuous auditing can be a significant tool to efficiently leverage internal audit resources, as well as effectively providing increased scope and focus to the internal audit plan and specific internal audit projects.

How is data analytics software used?



To what extent is data analytics applied during internal audits?





Leveraging technology

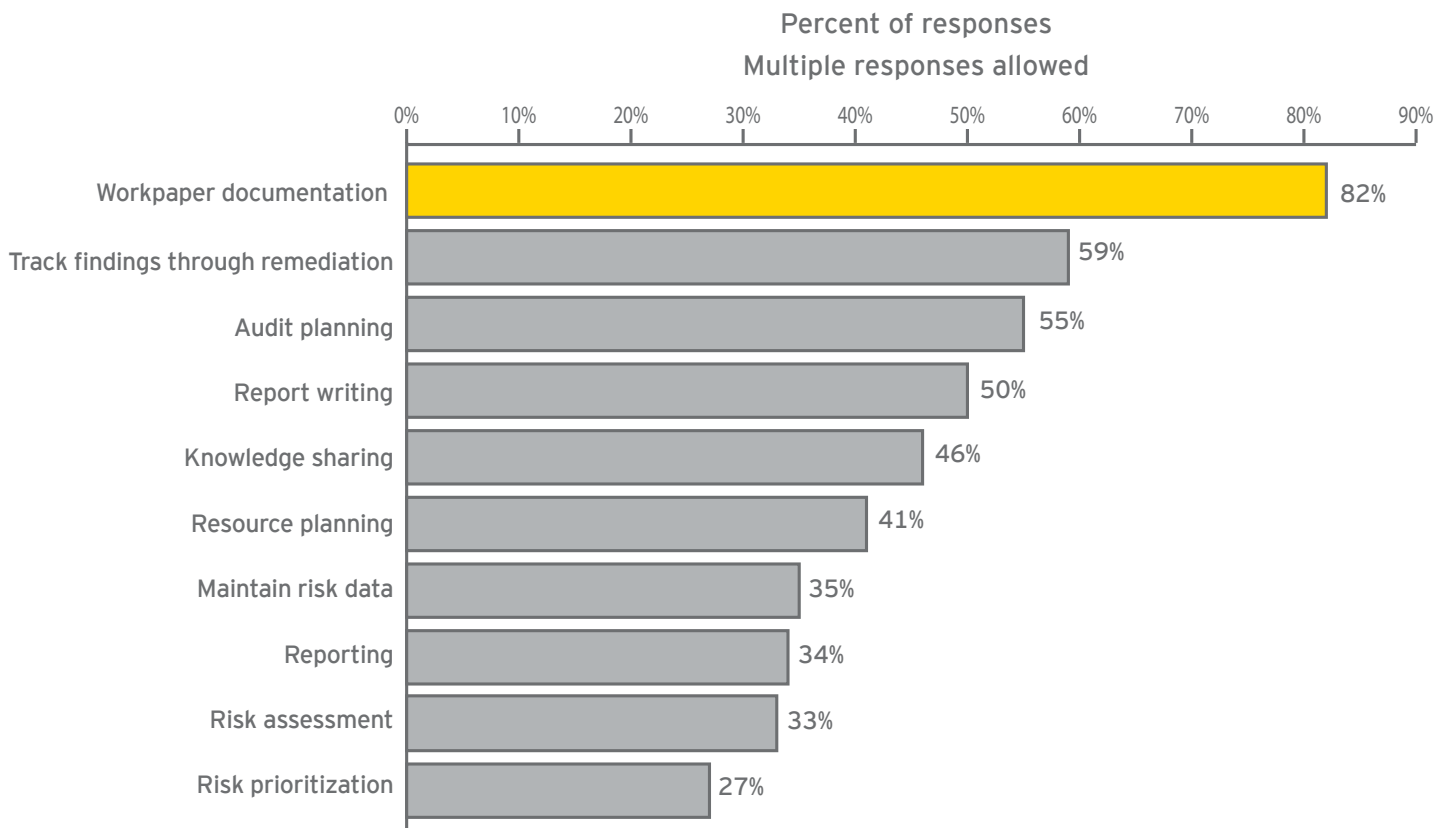
The significant increase in technology usage suggests that internal audit functions are realizing the cost benefit of tools that increase their efficiency and effectiveness. The growing role of technology has become a key identifier of highly effective internal audit functions. The survey found that most respondents use technology to document and maintain internal audit workpapers. Nearly half of all respondents use either AutoAudit for Windows® or TeamMate® as their internal audit and workpaper documentation tool. The efficiencies gained from using automated workflow tools allow internal audit functions to focus more time on the risks that matter and to continually develop the audit plan to meet their changing and expanding risk profiles.

As internal audit's focus on risk continues to evolve, so does the need for effective and intuitive technologies to support these efforts. Respondents

believe current technology falls short in providing the necessary intuitive functionality needed to enable risk assessments, risk prioritization and risk-based internal audit planning. At the same time, adequate training and practical, focused applications of data analytics techniques have come up short:

- ▶ Internal audit technology is used by 82% of the respondents for workpaper documentation, 59% for tracking findings, 55% for audit planning and by 50% for report writing.
- ▶ Forty-one percent of respondents who have not yet implemented a comprehensive internal audit tool plan to do so in the next 12 – 24 months.
- ▶ The top three areas where technology was rated as very effective in driving efficiencies are workpaper documentation, tracking findings and reporting.

How is internal audit technology used?





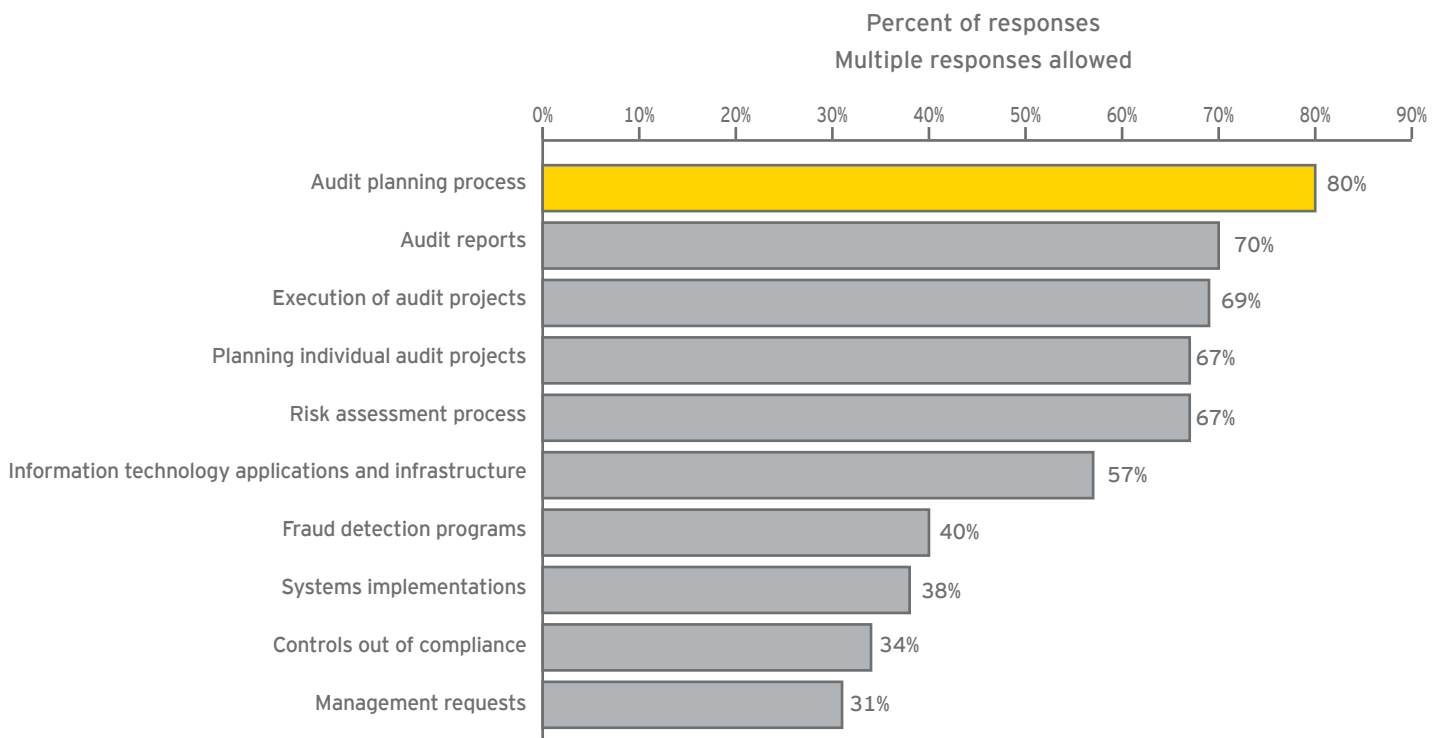
Knowledge management

Knowledge of specific industries, leading business practices and benchmark information is a key component of an effective internal audit function that should be used in supporting development of the internal audit plan, conducting risk assessments and preparing and conducting internal audits. Forty-four percent of respondents maintain a library of leading business practices, 83% of which maintain the information in a central database for common access across the function. But the survey identified that only 25% of organizations maintain a library of industry-standard business models.

Ideally, knowledge databases supporting the internal audit function include leading practices from within the company and are accessible by the entire internal audit function. Eighty percent of respondents in the survey indicated that leading practice knowledge is used to support their audit planning process. Approximately 7 out of 10 use leading practice knowledge to support their internal audit reports and execution of internal audit projects.

The use of both internal and external leading practice knowledge is a major contributor to internal audit's ability to be seen as a process improvement catalyst in the organization. The survey shows that approximately 25% of respondents have access to knowledge programs for internal control monitoring, IT risk, control and process improvement, enterprise risk assessment and fraud prevention.

For which of the following activities is leading practice knowledge available and used to support?





Measuring internal audit effectiveness

Aligning internal audit plans and performance metrics to include measurements based on supporting key business initiatives is one way noted to reinforce internal audit's relevance to key stakeholders. Value tracking is another mechanism being used to reinforce the relevance of the investment in internal audit, and includes cost savings and revenue enhancements, and the ability to promote well-qualified, knowledgeable and capable people into the business.

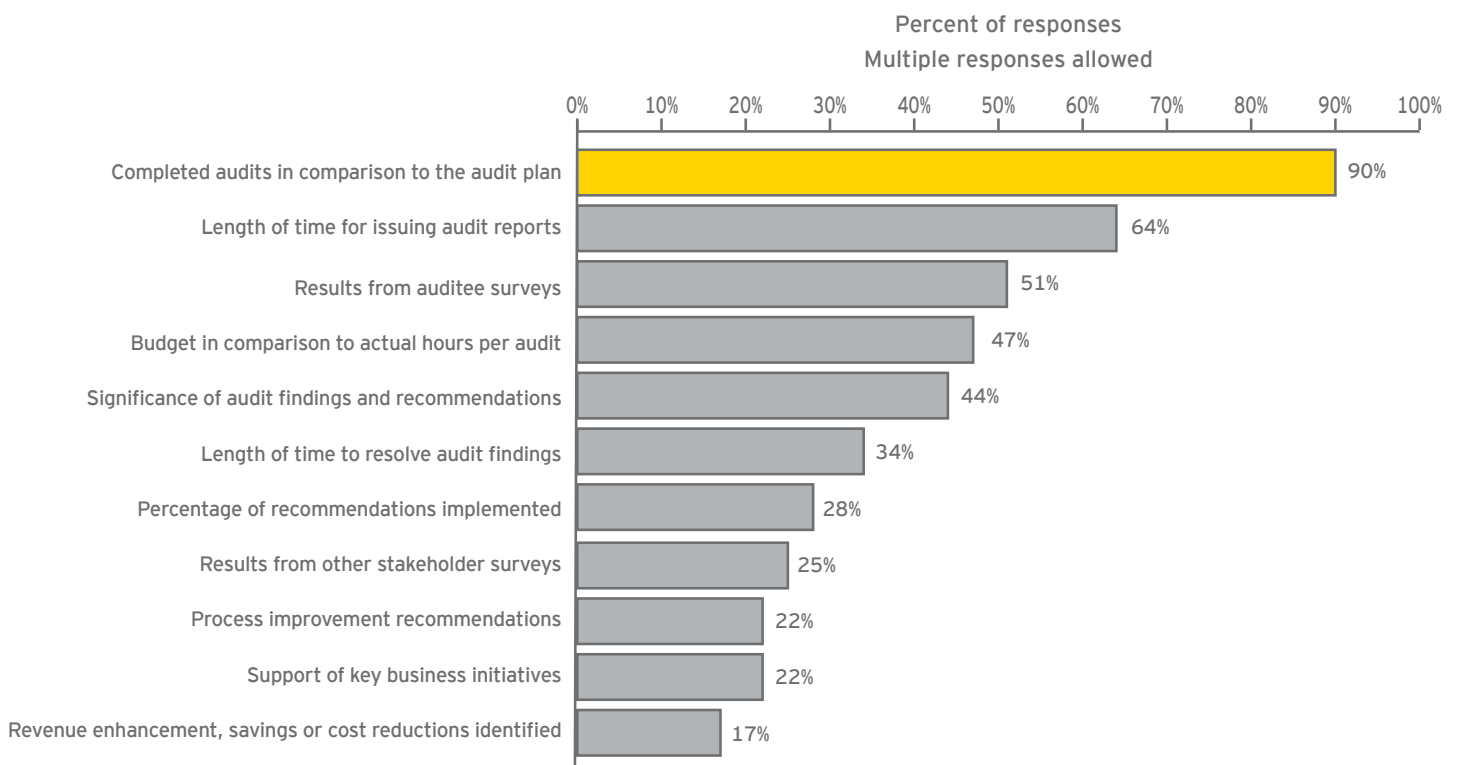
In measuring the effectiveness of internal audit, the top three metrics used by respondents are the completion of internal audits in comparison with the internal audit plan, the length of time taken to issue internal audit reports and results from stakeholder surveys. The survey found that only 34% of respondents use length of time to resolve internal audit findings and only 22% use support of key business initiatives as a key metric. When asked how the value internal

audit provides to the organization is tracked, 46% of respondents reported the use of auditee satisfaction surveys. Surprisingly, the survey also revealed that 19% of respondents do not formally track the value provided by internal audit.

This suggests a tremendous opportunity to refocus the leading indicators of internal audit success and value add in alignment with the latest trends in stakeholder expectations, e.g., business and operational improvement. That is, there must be an elevation of metrics such as the adoption of recommendations to management, the identification of issues relative to strategic initiatives (e.g., major capital programs), and a quantification of findings and recoveries from advanced data analytics techniques. In summary, raising the bar on value provided by internal audit must have a reciprocal set of measures and targets to capture that value.

Leading internal audit functions that are moving beyond compliance and into the role of advisor have changed the way they are measured.

What metrics are used to measure internal audit effectiveness?





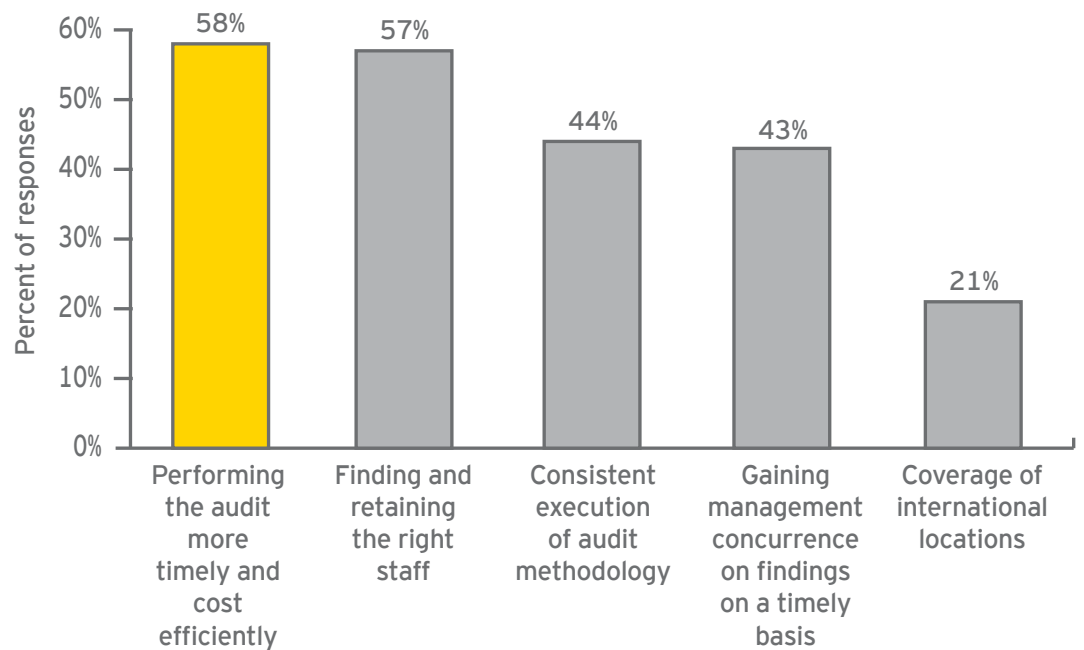
Demonstrating quality performance

Successful and consistent internal audit execution is dependent upon implementing processes that support quality work in all aspects of the internal audit function – governance, people, infrastructure and operations. Quality needs to be embedded and measured throughout the entire internal audit function to support the interdependence of the various elements and to meet the audit committee's and management's demands for a high-quality function. Half of the respondents perform an external quality review, with 68% of these reviews occurring within the last two years.

Our research shows that the primary challenge in the area of internal audit quality is difficulty delivering the audit in a timely and cost-effective manner. Fifty-seven percent indicate that the other top factor impacting quality is the ability to find and retain knowledgeable and experienced staff. In addition, the focus on compliance with the Institute of Internal Auditors' (IIA) standards continues to increase in importance. The survey shows that the percentage of respondents reporting at least moderate compliance with the standards has increased from 52% in our 2007 survey to 56% in this 2008 survey. In addition, 89% of this year's respondents use the IIA standards to some degree for guidance.

What are your biggest challenges in the area of quality of audit work performed?

Multiple responses allowed





What lies ahead for internal audit?

In today's turbulent economy, it is clear that internal audit's relevance in the organization is increasing. The results of our *2008 Global Internal Audit Survey* confirm that the ability to identify and manage risk is viewed as a key element of success in today's business world. Efforts over the last several years to embed risk and control activities within the business now provide internal audit with an opportunity to transform its role in risk management, becoming more strategic to the company. While this change has already begun at numerous companies, the survey reveals that many companies still have several opportunities to improve in key areas. The leading internal audit functions recognize this need for change and are realigning their resources to maintain a competitive edge in today's challenging and rapidly changing economic landscape. As a result, they will be best positioned not only to help keep their companies "out of trouble," but to help "make the business better."

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