Lessons Learned from Quality Assurance Reviews: Attributes of High Performing Internal Audit Functions
Presentation Overview

- Internal Audit Priorities – Pre-2002
- Internal Audit Headlines: The Last Five Years
- Changing Expectations of Key Stakeholders
- High Performing Internal Audit Functions Defined
- Attributes of High Performing Internal Functions
- Parting Thought – Navigating The Curve Requires Continuous Improvement
In the Pre-Enron Era – Internal Audit Priorities Were Dramatically Different:

- The search for relevance
- Focus on consulting and “Non-audit services”
- Control self-assessment
- Focus on operational and process improvement
- Divestiture of accounting expertise
- Declining resources
The Past Five Years Have Witnessed Seismic Changes - Headlines Have Included:

- Major realignment in internal audit’s reporting relationships
- Significant change in internal audit’s focus, roles, and responsibilities
- Greater employment of risk-based methodologies in determining priorities and allocating resources
- New communications strategies and practices to address enhanced stakeholder expectations
- Increased resources for internal audit functions to address increased demands
Demands/Expectations of Internal Audit’s Stakeholders Have Changed

**The Audit Committee and Board:**
- Execution of a comprehensive “risk based audit plan”
- Expertise and assurance on risks and controls
- Assistance in executing governance responsibilities
- Resident “eyes and ears” within the enterprise
- A “trusted advisor”

**Management:**
- Expertise and assurance on internal controls
- Insight, advice, and assurance on enterprise risks
- Timely and relevant information to facilitate risk management and business decisions
- Additional financial related coverage

**External Auditors:**
- Insight into the adequacy of financial controls
- Execution of a “risk-based audit plan” addressing financial risks – including relevant IT controls
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Attributes of High Performing Internal Audit Functions: The Basis of Our Views

- Observations accumulated from more than 200 QARs and related engagements conducted by PwC
- Documented in our proprietary benchmarking database – ProfilerTM
- Evaluated and scored performance related to 7 core internal audit processes
- High performing internal audit functions “consistently exceed stakeholder expectations, and exceed peer group scores in Profiler™ for virtually every core process.”
Attributes of High Performing Internal Audit Functions: “The Top 10”

1. Prominent Stature of Internal Audit Within the Organization
2. A Formal Strategic Plan for Internal Audit
3. Continuous Communications with Key Stakeholders
4. An HR Strategy Focused on Stakeholder and Enterprise Needs
5. A Risk Assessment Process that Produces Current Risk Profiles
6. Integrated IT Audit Coverage as a Component of an Overall IT Audit Strategy
7. Integrated IT Audit Coverage as a Component of an Overall IT Audit Strategy
8. A Knowledge Management Strategy
9. A Comprehensive Quality Assurance and Improvement Program
10. Performance Measures Linked to Strategic Goals
Attribute #1: Prominent Stature of Internal Audit Within the Organization

- Functional reporting relationship to the Audit Committee:
  - 86 percent, according to “2007 State of Profession Survey”

- CAE and Internal Audit viewed as:
  - Strategic
  - Part of senior management
  - A “trusted advisor” to management and the audit committee

- Relationship with the Audit Committee transcends the reporting relationship

- Chairman of the Audit Committee may have regular informal interaction with internal audit leaders
## Reporting Relationships: Current Trends

<table>
<thead>
<tr>
<th>Internal audit reports administratively to:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Audit Committee/Board</td>
<td>7%</td>
</tr>
<tr>
<td>CEO/President</td>
<td>31%</td>
</tr>
<tr>
<td>CFO</td>
<td>44%</td>
</tr>
<tr>
<td>Next Level Below CFO</td>
<td>3%</td>
</tr>
<tr>
<td>General Counsel</td>
<td>7%</td>
</tr>
<tr>
<td>Other</td>
<td>9%</td>
</tr>
</tbody>
</table>

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## Audit Committee Relationships: Current Trends

<table>
<thead>
<tr>
<th>CAE has a private session with the audit committee</th>
<th>Frequency</th>
</tr>
</thead>
<tbody>
<tr>
<td>Every audit committee meeting</td>
<td>58 %</td>
</tr>
<tr>
<td>At least audit committee meetings annually</td>
<td>19 %</td>
</tr>
<tr>
<td>At least once annually</td>
<td>13 %</td>
</tr>
<tr>
<td>Rarely – if ever</td>
<td>10 %</td>
</tr>
</tbody>
</table>

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Attribute #2: A Formal Strategic Plan for Internal Audit

- A formal strategic plan is developed and updated periodically
- Internal Audit’s strategic plan:
  - is aligned with enterprise strategies
  - is aligned with stakeholder expectations
  - delineates a vision of the future
  - serves as a basis for change and management of the internal audit function
A Formal Strategic Plan for Internal Audit: Key Strategic Issues That Should be Considered

- Who are internal audit’s stakeholders?
- What are stakeholder needs and expectations?
  - Financial focus?
  - Operational focus?
  - Compliance focus?
  - Strategic or business risks?
  - Consulting?
- What are key/emerging trends and risks facing the company and industry?
- How will internal audit be organized to deliver service?
- What specific goals or strategic initiatives are needed to bridge gaps and achieve internal audit’s strategic vision?
Attribute #3: Continuous Communications with Key Stakeholders

- Two-way communications beyond reporting audit results
- Communications extend beyond the CAE and include senior internal audit managers
- Communications have formal and informal components
- The CAE regularly communicates to senior management and the board:
  - Emerging risks facing the enterprise
  - Systemic trends on risks and controls gleaned from audit results
- CAE and internal audit managers also have frequent communications with the external auditors
Communications With Key Stakeholders: Recent Trends

<table>
<thead>
<tr>
<th>Frequency of meetings between internal audit managers and external audit managers:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Once per week</td>
<td>9 %</td>
</tr>
<tr>
<td>Once per month</td>
<td>24 %</td>
</tr>
<tr>
<td>Twice per month</td>
<td>13 %</td>
</tr>
<tr>
<td>Once per quarter</td>
<td>31 %</td>
</tr>
<tr>
<td>Semi-annually</td>
<td>13 %</td>
</tr>
<tr>
<td>Annually</td>
<td>9 %</td>
</tr>
</tbody>
</table>

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Attribute #4: An HR Strategy Focused on Stakeholder and Enterprise Needs

- Rotational strategies involving movement of staff into and out of Internal Audit and the business
- Common strategies observed in high performing Internal Audit functions
  - Total flow-through model
  - Partial flow-through model
  - Internal Audit rotation model
  - Guest Auditor programs
- Must have stakeholder support
- Must have appropriate training and development components within Internal Audit
Rotational Staffing Models: Current Trends

The staffing model currently in place in my internal audit department can be best described as:

<table>
<thead>
<tr>
<th>Staffing Model Description</th>
<th>F250 Responses</th>
<th>All Responses</th>
</tr>
</thead>
<tbody>
<tr>
<td>A rotational staffing model</td>
<td>7%</td>
<td>13%</td>
</tr>
<tr>
<td>A blend of rotational and career positions</td>
<td>31%</td>
<td>57%</td>
</tr>
<tr>
<td>All career positions</td>
<td>44%</td>
<td>30%</td>
</tr>
</tbody>
</table>

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# Rotational Staffing Models: Current Trends

<table>
<thead>
<tr>
<th>Typical length of a rotation in internal audit</th>
<th>All Responses</th>
</tr>
</thead>
<tbody>
<tr>
<td>About 1 year</td>
<td>11 %</td>
</tr>
<tr>
<td>About 2 years</td>
<td>38 %</td>
</tr>
<tr>
<td>About 3 years</td>
<td>28 %</td>
</tr>
<tr>
<td>Between 3 and 5 years</td>
<td>15 %</td>
</tr>
</tbody>
</table>

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### Rotational Staffing Models: Current Trends

<table>
<thead>
<tr>
<th>Are rotating staff afforded opportunities in audit management at conclusion of rotation?</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes, frequently</td>
<td>8 %</td>
</tr>
<tr>
<td>Yes, occasionally</td>
<td>51 %</td>
</tr>
<tr>
<td>No</td>
<td>42 %</td>
</tr>
</tbody>
</table>

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## Rotational Staffing Models: Current Trends

<table>
<thead>
<tr>
<th>Sources of recruitment for staff in rotational models</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Colleges and universities</td>
<td>28 %</td>
</tr>
<tr>
<td>Public accounting firms</td>
<td>81 %</td>
</tr>
<tr>
<td>Other companies</td>
<td>74 %</td>
</tr>
<tr>
<td>Business units within the company</td>
<td>49 %</td>
</tr>
</tbody>
</table>

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Attribute #5: A Risk Assessment Process that Produces Current Risk Profiles

- Beyond an annual risk assessment process – risk assessment should have a continuous component
- Continuous risk assessment process is formalized within internal audit and aligned with business units
- Risk assessments are transparent and interactive – involving senior management, external auditors, and the audit committee
- Emerging risks are identified and addressed through flexible internal audit coverage
# Internal Audit Risk Assessments: Current Trends

Enterprise-wide risk assessments are developed annually in my company by (Check all that apply):

<table>
<thead>
<tr>
<th>Option</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Internal audit only</td>
<td>36%</td>
</tr>
<tr>
<td>The Chief Risk Officer (or CRO organization)</td>
<td>12%</td>
</tr>
<tr>
<td>Jointly by internal audit and CRO</td>
<td>13%</td>
</tr>
<tr>
<td>Other business units within the company</td>
<td>14%</td>
</tr>
<tr>
<td>The external auditors</td>
<td>6%</td>
</tr>
<tr>
<td>No one prepares and enterprise-wide risk assessment</td>
<td>18%</td>
</tr>
</tbody>
</table>

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When completing an annual risk assessment, whose input is sought and considered?

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Senior management</td>
<td>95 %</td>
</tr>
<tr>
<td>Business unit managers</td>
<td>83 %</td>
</tr>
<tr>
<td>External auditors</td>
<td>44 %</td>
</tr>
<tr>
<td>Others</td>
<td>3 %</td>
</tr>
</tbody>
</table>

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## Internal Audit Risk Assessments: Current Trends

<table>
<thead>
<tr>
<th>How frequently is your company’s risk assessment updated and/or revised throughout the year?</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Continuously (more frequently than monthly)</td>
<td>7 %</td>
</tr>
<tr>
<td>Monthly to quarterly</td>
<td>18 %</td>
</tr>
<tr>
<td>Semi-annually</td>
<td>11 %</td>
</tr>
<tr>
<td>No regular interval – updated as needed</td>
<td>49 %</td>
</tr>
<tr>
<td>Not applicable – the annual risk assessment is not updated</td>
<td>16 %</td>
</tr>
</tbody>
</table>

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# Internal Audit Risk Assessments: Current Trends

Coordination and information sharing between internal audit and the organization’s other risk and control functions can be described as:

<table>
<thead>
<tr>
<th>Description</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Done on an informal basis only</td>
<td>31%</td>
</tr>
<tr>
<td>Actively working to improve the process</td>
<td>41%</td>
</tr>
<tr>
<td>A well-implemented process has been implemented</td>
<td>11%</td>
</tr>
<tr>
<td>A formal process has been put in place</td>
<td>7%</td>
</tr>
<tr>
<td>Not applicable – the annual risk assessment is not updated</td>
<td>3%</td>
</tr>
</tbody>
</table>

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Attribute #6: Integrated IT Audit Coverage as a Component of an Overall IT Audit Strategy

- Separate IT units are being deemphasized
- IT audit expertise/capability is integrated into:
  - Individual audit teams
  - Individual audit projects
- IT audit strategies/capabilities are aligned with the enterprise
- Continuous enhancement/training/development of IT audit staff to ensure capabilities to address enterprise IT risks
The IT Audit Strategy and Annual Plans: Ensuring Alignment

- Internal audit’s IT strategy should have a long-term focus that is compatible with the organization's overall IT strategy.

- The strategy should be clearly articulated and formally documented.

- The linkage between the risk assessment and the IT audit plan should be clear – however, an annual IT risk assessment should still be the backbone of the plan.

- The IT audit plan should also consider risks that are within individual business processes and not strictly within IT, in case those risks also have an IT component.
Attribute #7: Integration of Technology Solutions Into Multiple Aspects of Internal Audit Operations

- High performing internal audit functions embrace technology enthusiastically at all levels of the department.
- Technology solutions are leveraged as "capacity multipliers" to mitigate the impact of constrained resources.
- Use/expertise of tools not limited to IT audit.
- Requires continuous focus/upgrade as technology and enterprise risks evolve.
Technologies Significantly Enhance Internal Audit’s:

- **Efficiency**
  - Completely paperless audits
  - Automated issues tracking and reporting
  - Paperless audit report issuance and tracking
  - Scheduling and plan oversight

- **Effectiveness**
  - Automated testing of entire populations
  - Identification of errors or unusual transactions

- **Quality**
  - Force consistency and compliance with standards
  - Allow real-time reviews and issue escalation
Technology Solutions Typically Deployed in High Performing Internal Audit Functions:

- Integrated internal audit infrastructure software
  - Integrate workpapers, risk assessments, reporting, issues tracking
  - Automate administrative activities and monitoring
- Data retrieval / testing software
  - Automate testing
  - Require as a core competency skill for staff
  - Run testing routines outside audits
- Data mining/analysis software
  - Predictive analysis and modeling
- Knowledge tools and databases
  - “Best practices” to share with management
  - Business process benchmarking tools for IA
Attribute #8: A Knowledge Management Strategy

- Leverages the knowledge about enterprise risks and controls resident in internal audit
- Leverages technology to synthesize knowledge and make information readily available to:
  - Internal Audit management and staff
  - Business unit managers
  - Senior enterprise management
  - Other stakeholders, as appropriate
- Requires an investment to establish and maintain
Attribute #9: A Comprehensive Quality Assurance and Improvement Program

- Commitment to quality that extends beyond conformance to IIA standards
- Formal quality assurance and improvement program including:
  - Continuous quality controls
  - Periodic formal internal assessments
  - Periodic external assessments that include extensive benchmarking and insight on how internal audit compares with its peers
- Generally includes dedicated resources to manage the professional practices/quality assurance
Attribute #10: Performance Measures Linked to Strategic Goals

- Performance measures aligned to Internal Audit’s strategic plan
- Measures aligned with stakeholder values / expectations
- A balanced scorecard approach with a focus on outcomes, as well as outputs
- Annual goals established and communicated within Internal Audit and to the Audit Committee and executive management
- Performance is continuously tracked and communicated
Internal Audit Performance Metrics: Recent Trends

Internal audit has developed specific measures/metrics by which to assess performance:

<table>
<thead>
<tr>
<th>Agree</th>
<th>69 %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Disagree</td>
<td>31 %</td>
</tr>
</tbody>
</table>

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Internal Audit Performance Metrics: Our Observations

- Performance metrics take many forms
- Common output-based metrics:
  - Number of engagements completed
  - Number of findings
  - Number of recommendations
  - Average cycle-time for engagements
  - Average reporting cycle time
- Common outcome-based metrics
  - Client satisfaction
  - Number of recommendations implemented by management
  - Number of repeat findings/conditions
High Performing Internal Audit Departments Employ Leading Strategies, Methodology, Tools, and Other Practices
Leading Practices Are Not Static: Without a Continuous Focus on Improvement - High Performing Internal Audit Functions May Soon Be Lagging Their Peers

The curve is continuously moving: Today's Leaders Could be Tomorrow's Laggards
Questions or further discussion?

For more information, contact:

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PricewaterhouseCoopers LLP  

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richard.f.chambers@us.pwc.com