

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



Internal Auditor – December 2001

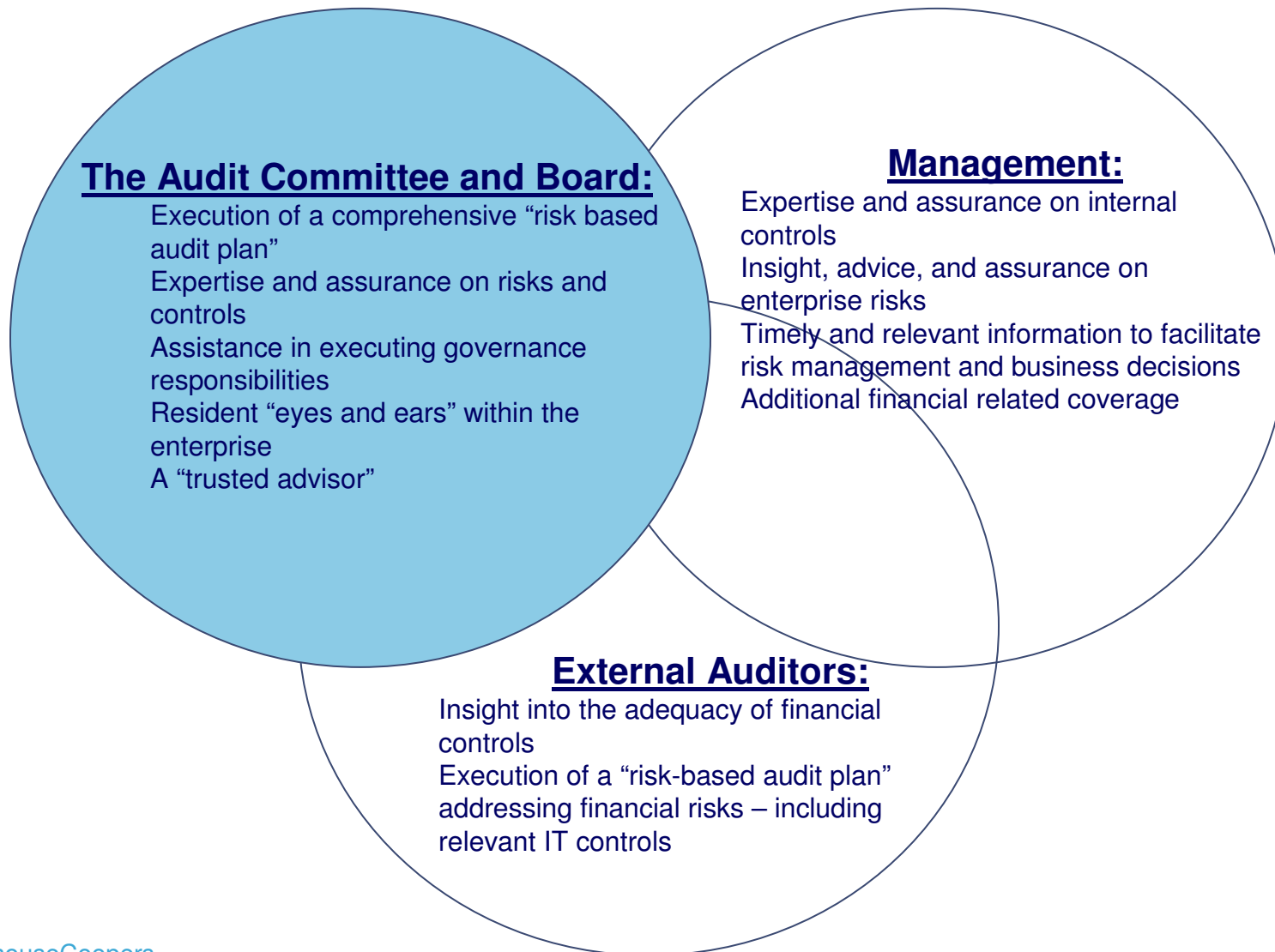
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The Past Five Years Have Witnessed Seismic Changes - Headlines Have Included:

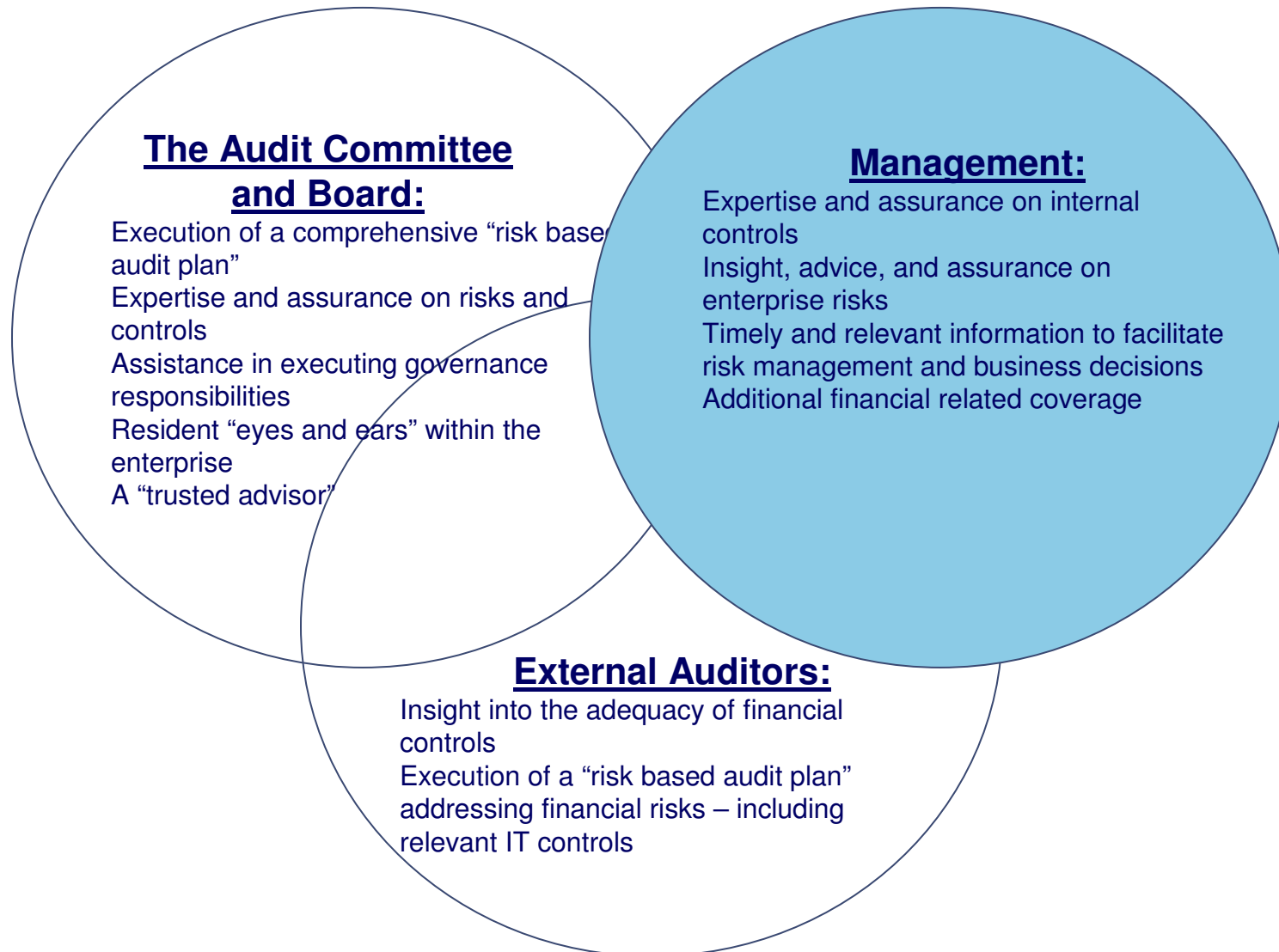
- Major realignment in internal audit's reporting relationships
- Significant change in internal audit's focus, roles, and responsibilities
- Greater employment of risk-based methodologies in determining priorities and allocating resources
- New communications strategies and practices to address enhanced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



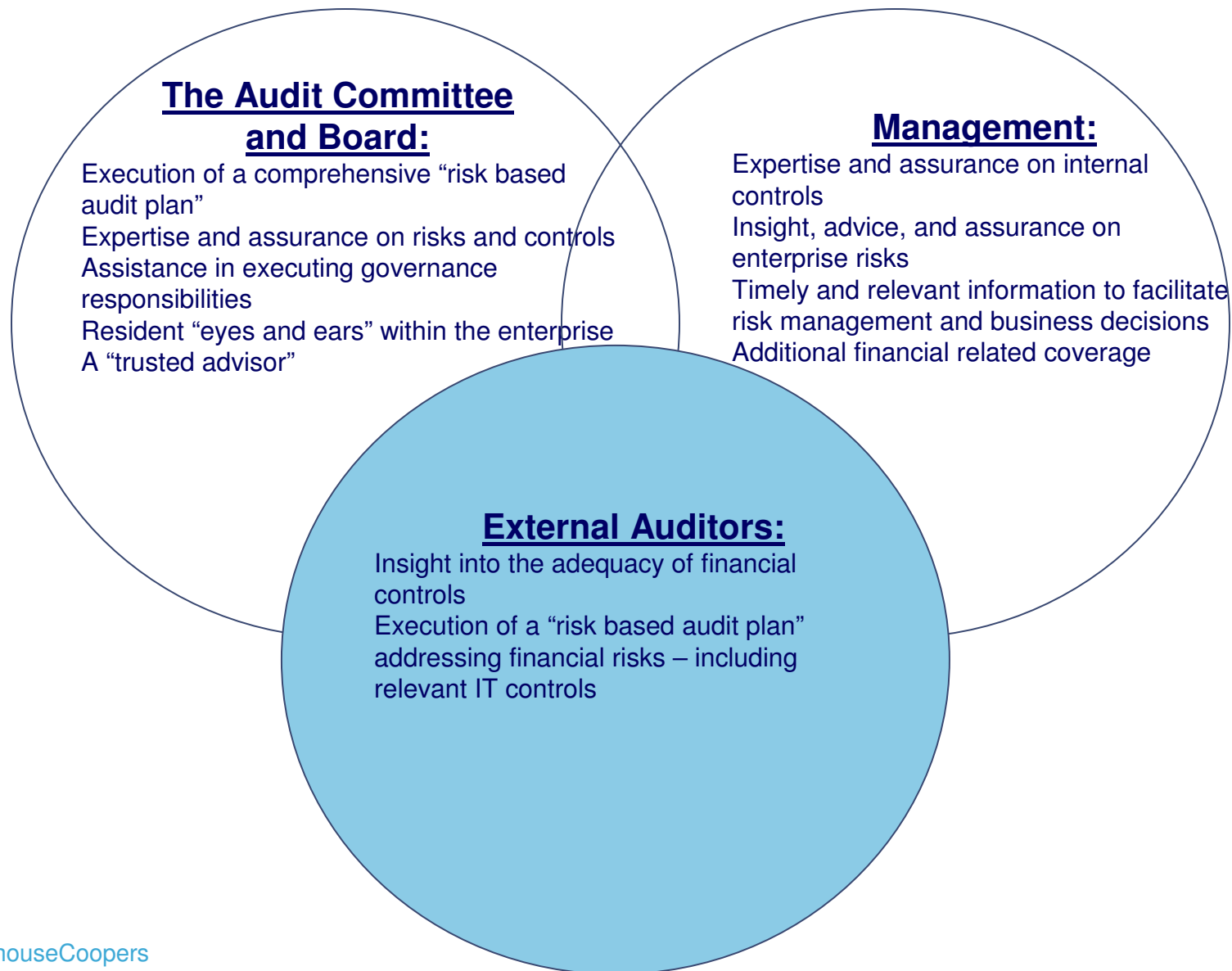
Demands/Expectations of Internal Audit's Stakeholders Have Changed



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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 – Profiler™
- 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

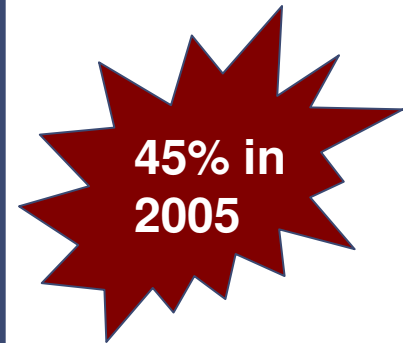
Internal audit reports administratively to:	
Audit Committee/Board	7 %
CEO/President	31%
CFO	44%
Next Level Below CFO	3%
General Counsel	7%
Other	9%

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Audit Committee Relationships: Current Trends

CAE has a private session with the audit committee	Frequency
Every audit committee meeting	58 %
At least audit committee meetings annually	19 %
At least once annually	13 %
Rarely – if ever	10 %



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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

Frequency of meetings between internal audit managers and external audit managers:	
Once per week	9 %
Once per month	24 %
Twice per month	13 %
Once per quarter	31 %
Semi-annually	13 %
Annually	9 %

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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:

Staffing Model Description	F250 responses	All Responses
A rotational staffing model	7 %	13 %
A blend of rotational and career positions	31%	57 %
All career positions	44%	30 %

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Rotational Staffing Models: Current Trends

Typical length of a rotation in internal audit	All Responses
About 1 year	11 %
About 2 years	38 %
About 3 years	28 %
Between 3 and 5 years	15 %

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Rotational Staffing Models: Current Trends

Are rotating staff afforded opportunities in audit management at conclusion of rotation?	
Yes, frequently	8 %
Yes, occasionally	51 %
No	42 %

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Rotational Staffing Models: Current Trends

Sources of recruitment for staff in rotational models	
Colleges and universities	28 %
Public accounting firms	81 %
Other companies	74 %
Business units within the company	49 %

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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):	
Internal audit only	36 %
The Chief Risk Officer (or CRO organization)	12 %
Jointly by internal audit and CRO	13 %
Other business units within the company	14 %
The external auditors	6 %
No one prepares and enterprise-wide risk assessment	18 %

Only 20 % believe well aligned

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Internal Audit Risk Assessments: Current Trends

When completing an annual risk assessment, whose input is sought and considered?	
Senior management	95 %
Business unit managers	83 %
External auditors	44 %
Others	3 %

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Internal Audit Risk Assessments: Current Trends

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

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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:	
Done on an informal basis only	31 %
Actively working to improve the process	41 %
A well-implemented process has been implemented	11 %
A formal process has been put in place	7 %
Not applicable – the annual risk assessment is not updated	3 %

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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:

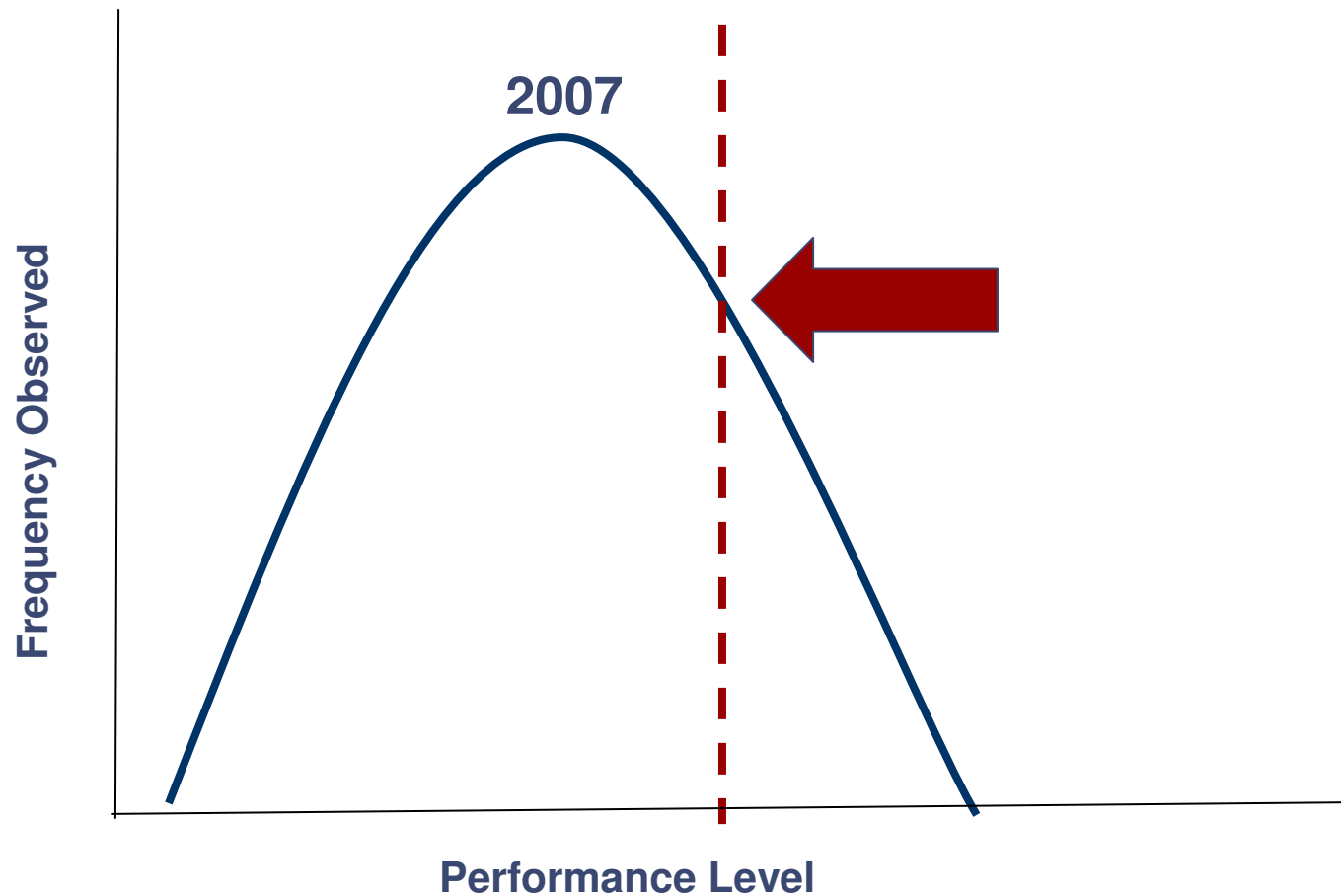
Agree	69 %
Disagree	31 %

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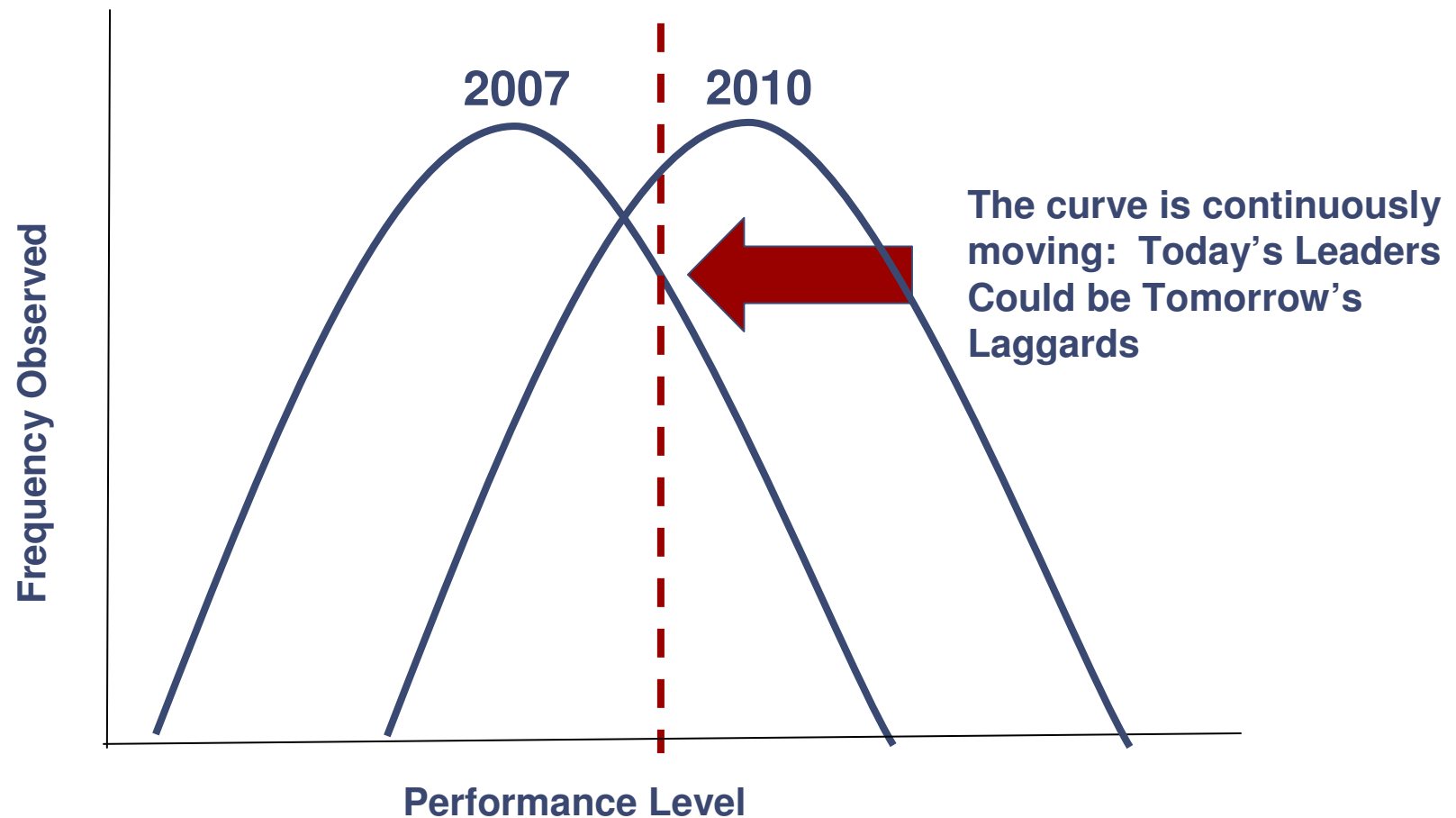
Internal Audit Performance Metrics: Our Observations

- 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



Questions or further discussion?

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