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Global Internal Audit Survey

A current state analysis with insights into
future trends and leading practices

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The Shifting Internal Audit Landscape

The Internal Audit landscape, recently dominated by financial reporting compliance-related efforts, is now being challenged by pressures on resources and growing demands to help improve overall business performance.

To help gauge these shifts in the global Internal Audit industry, and to gain insight into future and leading trends, Ernst and Young recently conducted a survey of Internal Audit executives worldwide.

In short, the survey reveals that Internal Audit is in the middle of an evolutionary transition, facing great challenges, as well as new opportunities. There is a call for Internal Audit to do more to meet the needs of its stakeholders.

The key findings are:

- Stakeholder expectations are increasing with greater focus on enterprise-wide risk assessment and business and operational risk.
- In implementing enterprise-wide risk assessments, as well as covering of key risk areas, there is an opportunity for Internal Audit to improve coordination with other risk management groups within the company.
- People are still the foremost challenge for Internal Audit functions around the globe: recruiting, retooling, developing, and retaining the right skills.
- Industry, IT, fraud, and business and operational risk are the specialized skills most difficult to recruit and retain. These are also among the areas which respondents indicated pose greater risks to their companies.
- There is an opportunity for Internal Audit to better leverage technology and knowledge collection/sharing tools to improve effectiveness and efficiency significantly.

Internal Audit functions around the world have the opportunity to expand their impact on – and improve their companies' performance in – enterprise-wide risk, particularly in areas such as fraud, major capital programs (including IT), contracts, transactions and international expansion. The potential for increasing Internal Audit's strategic relevance is great. Our survey shows that Internal Audit's expanded role in these areas is not only an objective, but is also expected.

What had once been only desired is now a necessity.

Complicating matters are Internal Audit's efforts to reconcile the sometimes-divergent objectives of the Audit Committee and executive management. While the Audit Committee is interested in keeping the company out of trouble, executive management is also interested in Internal Audit's point of view on improving business performance.

These new pressures, coupled with Internal Audit's uniquely well-positioned role, make understanding what is happening – and how to respond – a critical success factor.

Stakeholders, including the Board of Directors, the Audit Committee, employees, regulators and stockholders are watching to see how Internal Audit functions will respond. In order to meet these expectations, and to become more strategically relevant, Internal Audit leaders need to continue to think differently and react quickly.

Setting The Scene For The Survey

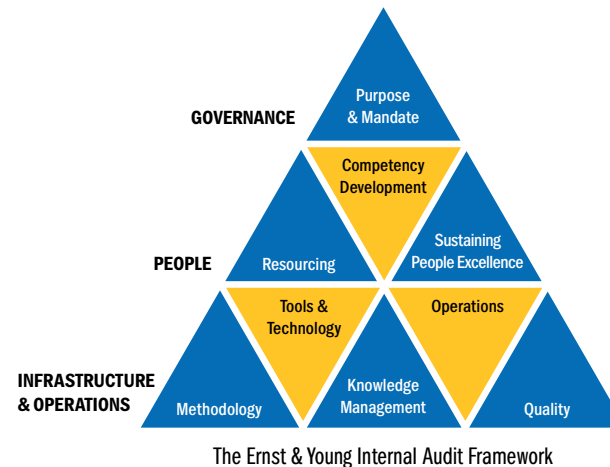
Stakeholders have long expected that Internal Audit functions keep their companies “out of trouble”. Now, there is an expectation that Internal Audit will also help to “make the business better” through improved performance thereby helping to improve the company’s return on investment.

It is because Internal Audit is well-positioned to understand so many different aspects of the company that it finds itself in the middle of tremendous change *and* opportunity.

About The Survey

This report highlights the findings of our survey of Internal Audit executives representing 138 predominately public companies representing membership in the *Global Business Week 1000*, and the *Standard & Poor’s Global 1200* from 24 countries. Most of the participants’ companies were large multinational functions with revenues over US\$ 4 billion.

To help structure the survey results, we used Ernst and Young’s Internal Audit Framework, which has been used by a number of leading companies to analyze their Internal Audit function. The 2007 Global Internal Audit Survey results therefore examine Internal Audit functions across three basic categories:



- **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 audits and provide service

After several years of compliance-related investment and increased international competition, stakeholders are looking to Internal Audit – with its unique perspective that spans the highest levels of the company down to the granular aspects of daily operations – to help management produce favorable returns.

Governance

Our survey results indicate that the number of companies where Internal Audit maintains the primary burden for full regulatory compliance and internal control over financial reporting and testing is still relatively high.

Compliance and Financial Reporting Efforts are Still Substantial

At this stage of the global push for increased compliance, especially for SEC registrants, many might expect that Internal Audit functions would now be moving toward a more limited role, focusing more on the testing of higher risk and/or more complex areas. But our survey indicates that the number of companies where Internal Audit maintains the primary burden of testing internal control over financial reporting is still relatively high.

Although the demands for compliance testing are declining for most Internal Audit functions, our survey showed that over 36% of the SEC-listed companies required to comply with SOX 404 responded that their Internal Audit function still has full responsibility for testing all SOX 404 controls.

Increased Focus on Business and Operational Risk

In light of the changing demands, many Internal Audit functions are looking to better-align audit coverage with the company's major business and operational initiatives and risk areas. Focus areas include major programs, contract management, international expansion, transactions, and major change initiatives.

Nearly three-quarters of respondents indicated involvement in business process improvement. Fifty eight percent indicated involvement in contract auditing, and 57% involvement in the auditing of major programs. Nevertheless, the respondents recognized significant opportunities for Internal Audit to increase its effectiveness in these areas. In order to do so, Internal Audit must retool existing resources and add new resources/skills to these areas.

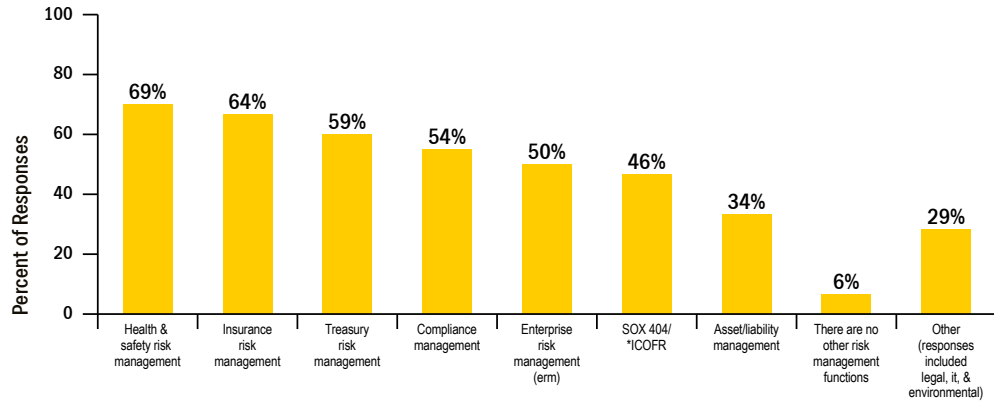
Enterprise Risk Assessment Gaining Momentum

Better integration among all risk management functions within the organization, including Internal Audit, is a major factor in improving the effectiveness of the enterprise risk assessment process. In larger companies with multiple risk management functions, risk assessment and coverage activities need to be clearly defined, coordinated, and aligned with the company's strategic objectives.

Our research shows that many Internal Audit functions are involved in (and, in many cases, leading) an enterprise risk assessment process so those functions can refocus their efforts on the risk areas that have a significant impact on the business. Seventy-seven percent of companies surveyed perform an enterprise risk assessment. Many further indicated deploying the leading practice of refreshing this assessment at key intervals throughout the annual audit cycle. Respondents indicated that there are significant improvement opportunities in the scope and level of coverage across specific risk categories, especially operational, compliance, and strategic risk.

The majority of companies surveyed have multiple risk management functions, in addition to Internal Audit, within their organization. Fifty percent of the companies surveyed have formal enterprise risk management functions. The growing perception that executive management has a relatively higher level of accountability than in the past creates an opportunity for Internal Audit to contribute to the formalization and integration of risk management within the company.

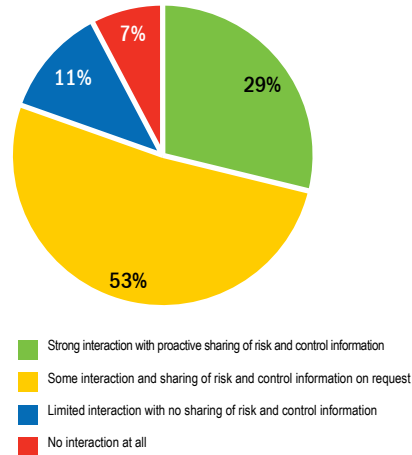
In addition to Internal Audit, what are the other formally recognized risk management functions within the organization?



*ICOFR - Internal Controls Over Financial Reporting

However, only 29% of respondents indicated that Internal Audit has strong interaction and alignment with other risk management functions in the company, with proactive sharing of risk and control information. This suggests a significant opportunity for improved alignment, through the Internal Audit framework. There is a challenge for Internal Audit, together with people at all levels of the company, to build risk management into business management.

What is the level of interaction between Internal Audit and the other risk management functions within the company?



People

The increase in demand for qualified personnel, especially those with specialized skills, is creating a challenge for Internal Audit functions looking to fulfill the increasing expectations.

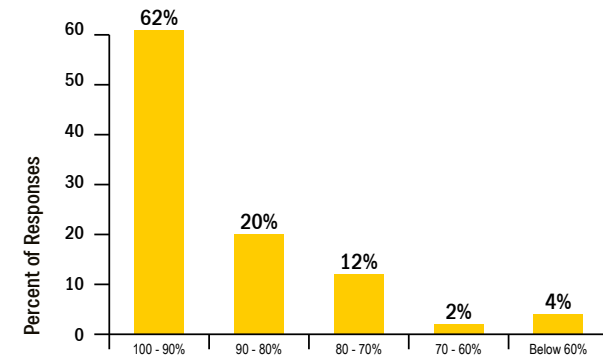
“War for Talent” Is the Top Issue Facing Internal Audit Functions

The “war for talent” continues to be the greatest challenge for many Internal Audit functions. Although it appears that Internal Audit is able to secure an adequate budget, it struggles to attract and retain “the right type of talent”. This leads to gaps in Internal Audit coverage and challenges in completing the Internal Audit plan.

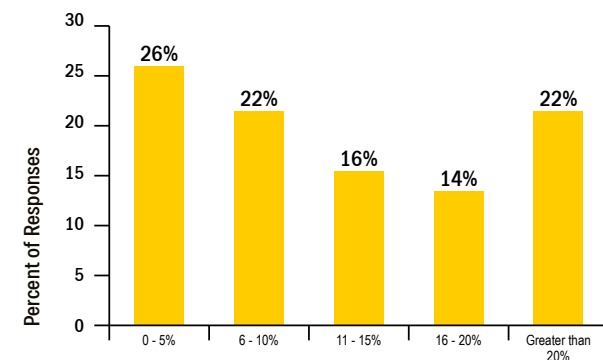
The survey found that:

- Forty-nine percent of respondents indicated an increase in the size of the Internal Audit function during the preceding 12 months, while 11% decreased, with the remaining 40% unchanged.
- Thirty-eight percent of respondents indicated they are operating at less than 90% of budgeted headcount.
- Over one in five Internal Audit functions has an annual staff turnover in excess of 20%. Thirty-six percent of respondents reported an estimated annual staff turnover rate of more than 15%.

What percent of your Internal Audit function is staffed in comparison to your budgeted headcount?



What is your estimated annual personnel turnover percentage?



Acquisition of Specialty Skills Is Particularly Challenging

As a result, leading Internal Audit functions are transforming their people model in a variety of ways including: retooling existing resources, hiring new skills into the function, implementing rotational programs, and developing relationships with third-party service providers.

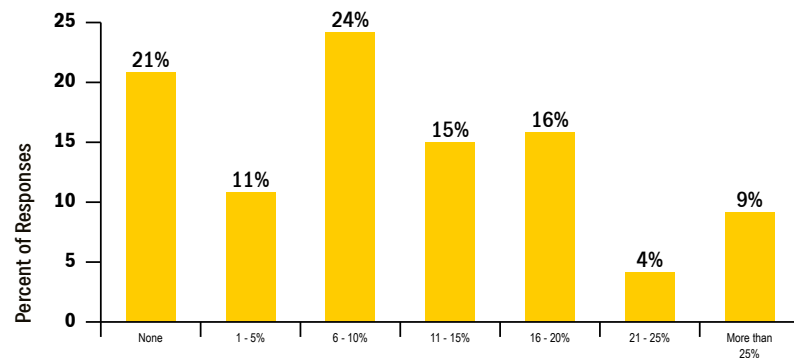
Respondents are facing a number of hurdles in the drive to find and train “the right people”. The top skills that are among the most difficult for Internal Audit to recruit are, in order, IT auditing, industry experience, and fraud prevention/detection.

To help illustrate this difficulty, the survey reveals that IT auditors represent only 10% of the Internal Audit headcount for over half of respondents’ Internal Audit functions. In today’s environment, leading Internal Audit functions have 25% of their staff focused on IT activities.

Further, more than a third of respondents indicated that they do not have staff trained in fraud prevention/detection. Other significant skill gaps in key risk areas include transactions, tax, major programs, and contract auditing.

One of the greatest challenges many respondents cite is having too many Internal Auditors with financial reporting compliance skills, but lacking Internal Auditors with the specialized skills to meet the needs of the company’s evolving risk profiles.

What is the percentage of IT auditors on your staff?



People

There is a significant retooling effort required to expand Internal Audit skill sets from financial reporting compliance to business/operational risk competencies, as well as meet the expanding expectations of stakeholders to benefit the business.

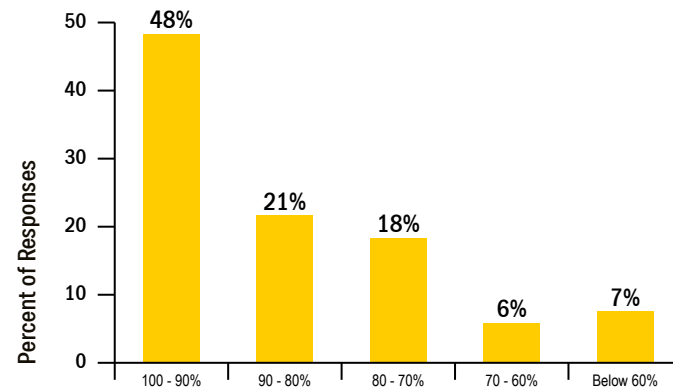
Competency Development May Need Greater Focus

Many Internal Audit functions need to invest more heavily in competency models and training plans, upgrade training curriculums and increase the required hours for staff training each year. However, this appears to be a major challenge for many functions.

Nearly half of the respondents (47%) require up to 40 hours of annual training for Internal Audit staff. Forty-three percent of the respondents do not have formal competency models/training requirements by level or by individual.

As the chart below shows at least 52% of the respondents' staff did not meet their training requirement standards in the last year.

What percent of your staff met their Internal Audit training requirements during the past year?



International Coverage Is A Major Challenge

There are numerous challenges to the provision of effective Internal Audit coverage for international operations. These include:

- Differences in language and culture;
- Knowledge of local laws, regulations and accounting standards;
- A reluctance among Internal Audit staff to travel;
- Adherence to quality standards; and
- Increased costs.

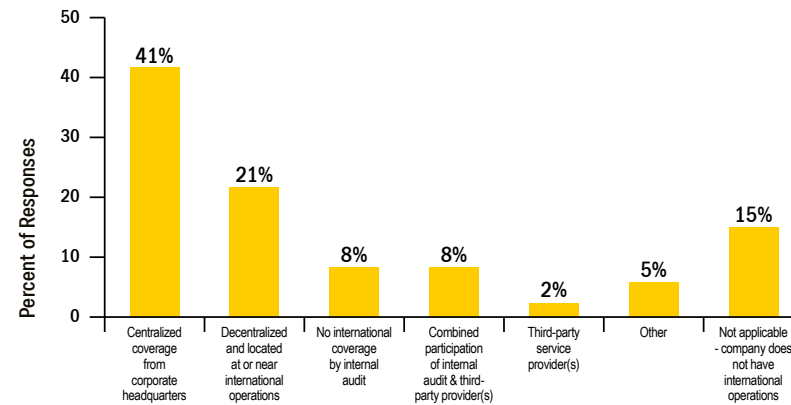
Our survey found that a higher-than-expected (41%) percentage of Internal Audit functions are attempting to provide international coverage from corporate headquarters, which provides limited ability to address the challenges noted above. Not surprisingly, only 34% of respondents are “highly satisfied” with Internal Audit coverage of their international operations.

Multiple Factors in Retaining the Best Talent

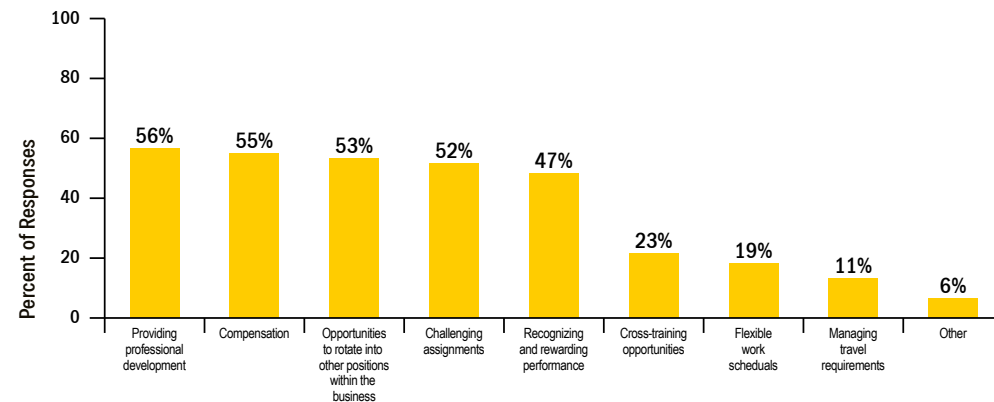
Competitive compensation is only one of the many factors that impacts efforts to develop and sustain high-performing organizations. Other factors – such as training, mentoring, career opportunities, and new and challenging assignments – are equally important and, collectively, may be more important than compensation.

Leading practice would dictate that addressing the challenge of creating adequate competency models would facilitate training plans, performance management systems, and the attraction of top talent to the Internal Audit function.

How are you covering your international operations?



What factors are most important in retaining Internal Auditors?



Infrastructure and Operations

Audit Committees and executive management increasingly expect that Internal Audit shares not only the risks covered in the Internal Audit plan, but also risks that are *not* covered by the Internal Audit plan.

Risk Assessment Trends and Opportunities

In a dynamic business environment, organizations face potential new risks or increased exposure from existing risks. This has resulted in many Internal Audit functions refreshing their annual risk assessment at least once a year – sometimes quarterly – in an effort to understand a changing risk profile, and to help make sure they have the tools in place to address these risks.

We asked respondents how often their companies updated the risk assessment and Internal Audit plan during the year:

- Eighty-nine percent of respondents conduct a risk assessment to support the Internal Audit planning process
- Forty-four percent of respondents update their risk assessment semi-annually, quarterly, or prior to conducting Internal Audits
- Only 44% of respondents provide standardized training to individuals responsible for conducting a risk assessment

Only 43% of respondents present risks not covered by the Internal Audit plan to the Audit Committee. Institutional investors rate transparency as a key factor in making the decision to initiate an initial investment in a company. Ernst & Young's 2007 *Risk Management in Emerging Markets Survey* also found that there is clear room for improvement in the documentation and, therefore, communication of the risk assessment process across a company.

Completing the Internal Audit Plan

The difficulty in completing the Internal Audit plan during the audit cycle has been a consistent trend over in recent years. For some companies, efforts to comply with financial reporting compliance regulations continue to divert a significant portion of the Internal Audit plan and resources away from other Internal Audit efforts.

Again, this effort is being complicated by the challenge many Internal Audit functions have in finding and retaining the right talent to address areas of the Internal Audit plan requiring specialized skills.

- Only 21% of respondents were able to complete the prior year Internal Audit plan
- Only 24% completed up to 80% of the plan

Our Risk Management in Emerging Markets Survey found that those individuals closest to the risk are often in the best position to assess the steps necessary to reduce their companies exposure to the risks. Internal Audit's scope of responsibility is increasing beyond the level and/or skills base of its resources. An internal auditor from company headquarters is often not well placed to test a subsidiary's risk. Internal Audit needs to be done locally by people with the appropriate knowledge. Respondents to Ernst & Young's *Companies on Risk Survey* commented that they expect that greater alignment of Internal Audit with line management will lead to more effective decision making and communication across the business.

Interest in Continuous Internal Auditing Is Increasing

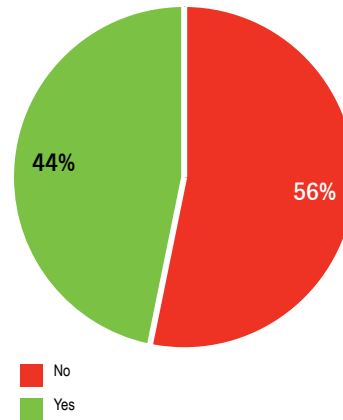
Continuous auditing has a significant impact on Internal Audit efficiency, especially as it migrates from manual to automated operations. Several elements need to be in place to fully leverage a continuous auditing program: a detailed plan of specific program objectives and resources/budget, the requisite skill sets to plan and implement the program, and executive management support for the initiative.

More than half of the survey's respondents (56%) have not implemented a continuous auditing program. Reasons for not doing so include perceived lack of value, lack of relevant skills, and budgetary constraints.

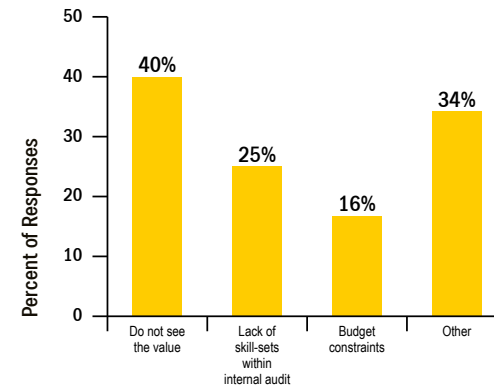
Of the respondents who have not implemented continuous auditing, approximately half plan on doing so in the future.

The 44% of respondents who have implemented continuous auditing list key activities including follow-up on recommendations, identifying control deficiencies, monitoring risks, and identifying potential fraud.

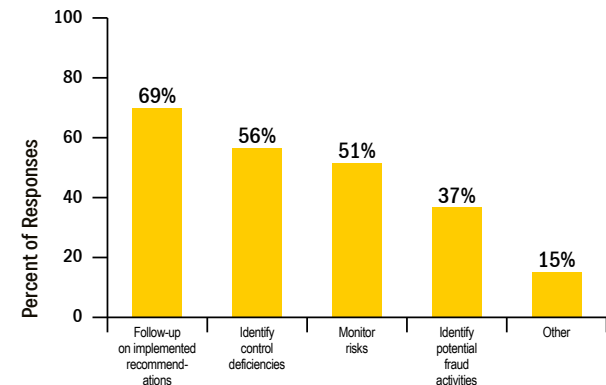
Does internal audit utilize continuous auditing?



If Internal Audit does not use continuous auditing, why not?



If Internal Audit does use continuous auditing, what are the key objectives?



Infrastructure and Operations

Successful implementation of more sophisticated - and integrated - Internal Audit tools requires proper planning, resources, and budget.

Use of Data Analytics

Many Internal Audit functions have limited capabilities to leverage data analytics effectively. As a result, data analytics are often relegated to relatively simple financial analysis and graphics support.

Leading Internal Audit functions use data analytics for numerous activities, including risk assessment, planning, execution, and reporting. Additionally, data analysis 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 analysis.

Ninety-three percent of respondents indicated that their Internal Audit functions use data analytics. However, only 42% of the respondents indicated that more than 60% of their staff is proficient in the use of data analytics.

Tools and Technology Usage

Another area of potential improvement for Internal Audit includes enhancing specialized tools to facilitate work streams, collaborative efforts, knowledge exchange, and increased work mobility.

Successful implementation of more sophisticated - and integrated - Internal Audit tools requires proper planning, resources, and budget. As a result, these short-term investments are likely to benefit the company.

Tools and technologies implemented by Internal Audit typically support work papers (87%), audit planning (73%), reporting (71%), report writing (59%), tracking findings through remediation (52%), and knowledge sharing (51%).

Specialized tools to support Internal Audit activities. The majority of respondents use Microsoft® applications (53%), followed by in-house systems (27%). Investments in other, more sophisticated tools is still limited but increasing.

Fraud Prevention and Investigation

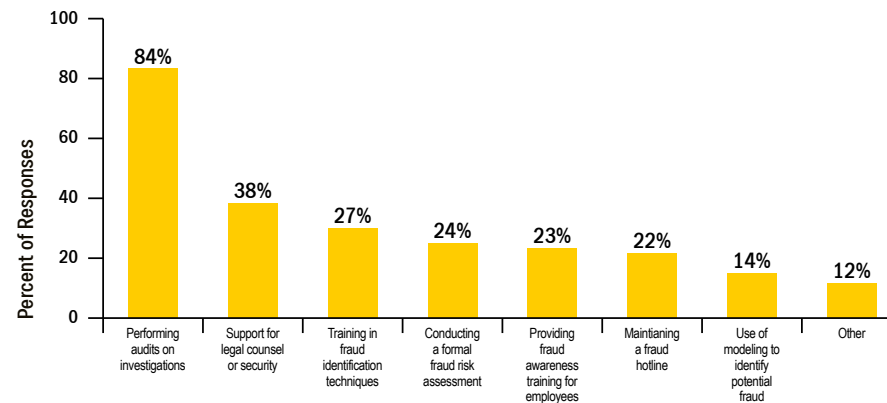
Regulators around the world are requiring organizations to become more vigilant regarding fraud. As such, leading Internal Audit functions are proactively investing more in fraud prevention, such as fraud risk assessment, data analytics for the early detection of fraud, and fraud awareness training.

Nearly 65% of respondents indicated that fraud is a “very significant” or “somewhat significant” risk to their organization.

Proactive fraud prevention, such as increasing awareness, identifying areas of vulnerability, and aiding in early detection of fraud, are less common among respondents than reactive activities. For example, providing fraud awareness training, conducting fraud risk assessments and utilizing modeling to identify potential frauds were far less frequently noted by respondents than the execution of Internal Audits and investigations.

Fraud investigations have become more complex, especially with regard to privacy regulations. Organizations need to use subject matter specialists to conduct fraud investigations, obtain and maintain attorney-client “privilege”, exercise proper control over the chain of evidence which serves to limit the organization’s exposure/liabilities in the event of litigation.

What is Internal Audit's role in the company's fraud prevention and investigation program?



Infrastructure and Operations

Knowledge of specific industries, leading practices, and benchmark information is a key component of an effective and efficient Internal Audit function. This knowledge should be included in the training and development of new and existing staff.

Knowledge Management

Ideally, knowledge databases supporting the Internal Audit function should not only include leading practices from within the company, but also should extend to other leading companies as well.

When asked how they expect their Internal Audit function will expand the use of leading practices and benchmarking data to support audit activities, only 47% of respondents indicated that they maintain a library of leading practices. Thirty-six percent indicated that they maintain industry-based business process models.

Sources of knowledge for Internal Audit functions are varied, with the three main sources being the Institute of Internal Auditors, professional service firms, and industry trade associations.

Measuring Internal Audit Effectiveness

The top two metrics used in measuring Internal Audit effectiveness include:

- Completed Internal Audits in comparison to the Internal Audit plan (89%)
- The length of time for issuing Internal Audit reports (72%)

Only 32% of respondents use length of time to resolve Internal Audit findings as a key metric, while 23% use support of key business initiatives.

Surprisingly, the survey revealed that half of the respondents do not track the value their Internal Audit functions provide to the organization, while 13% measure value based upon actual cost savings.

To reinforce their relevance to key stakeholders, Internal Audit needs to align Internal Audit plans and performance metrics to support key business initiatives. Value tracking is a mechanism which can reinforce relevance as well as help justify the Internal Audit investment. As Internal Audit's involvement in certain business/operational risk areas increases – such as program auditing and contract auditing – tracking value will become more applicable.

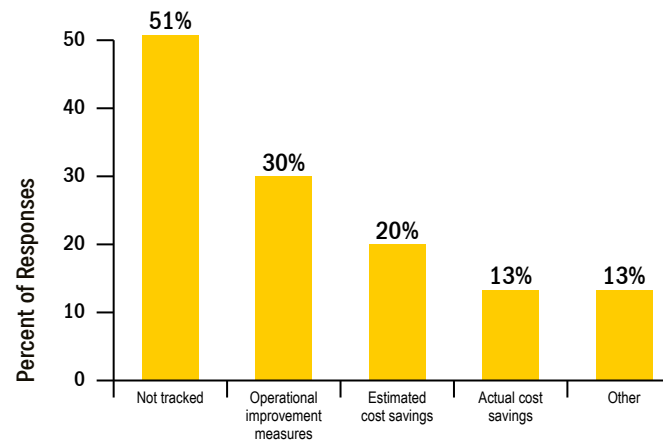
Measuring Internal Audit Quality

In an effort to better understand how companies enhance their Internal Audit functions to achieve continuous improvement of service quality, and adherence to Internal Auditing standards, we asked what steps respondents are taking to measure it:

- Eighty percent of respondents use the closing meeting, while 48% of respondents use a post-Internal Audit survey
- Fifty-two percent of respondents maintain moderate to strict compliance with Institute of Internal Auditor standards
- Forty-eight percent of respondents have had an external quality assessment review

Leading organizations combine a quality assessment review with a functional performance assessment to conduct a current state/desired state Internal Audit gap analysis and to create an improvement plan for the function.

How does Internal Audit track the value provided to the organization?



Conclusion

Our 2007 Global Internal Audit Survey reveals that Internal Audit functions around the world are being challenged in many ways. The challenges are numerous. But so are the opportunities of growth, impact and influence.

While the survey provides strong insight into the efforts by Internal Audit functions around the world to strike a balance, it also raises questions for the future:

- Can Internal Audit functions successfully reconcile the sometimes-divergent goals of the Audit Committee, and executive management, finding a path that allows them to meet new expectations?
- How will Internal Audit functions continue to add value to their companies' efforts to improve their business and operational performance?
- Has the Internal Audit function identified and shared risks that are covered and *not* covered in their Internal Audit plan with the Audit Committee and executive management?
- Can Internal Audit functions continue to integrate their efforts with other risk management functions within their respective companies and gain better alignment to make risk management more effective and efficient?
- How will Internal Audit functions find and keep the right people, and retool existing personnel, particularly in areas where needs are acute such as fraud, IT, and unique business and operational risks?
- Can Internal Audit functions leverage the benefit of technology tools and knowledge to help improve overall coverage and relieve pressure on resources?

Our 2007 Global Internal Audit Survey demonstrates a changing landscape and presents a significant opportunity. Those Internal Audit functions that are more able to answer the questions above and take advantage of these opportunities will thrive in the future.

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