

PwC Advisory
Internal Audit

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Internal Audit at a Crossroads:

Leading Practices Today and Likely Trends for the Future*

Presented to
The Institute of Internal Auditors
Tampa Bay Chapter

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Agenda

Recap of Recent Trends Impacting Internal Audit

Highlights from the 2007 State of the Profession Survey

Summary of 2012 Research Results

Internal Audit at a Crossroads

Five Key Trends Reshaping Internal Audit

Ten Imperatives for Success in the Next Five Years

Overarching Trends from the Past Five Years

- Increased focus/expectations from key stakeholders
- Greater stature for internal audit departments
- Increased focus on financial controls
- Enhanced role in fostering compliance with statutes and regulations
- Greater competition for scarce internal audit resources



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Highlights from Our 2007 State of the Profession Survey

- Pressures are building for continual focus on risk
- The impact of Sarbanes-Oxley is continuing – but many internal audit functions did not achieve anticipated reductions in 2006
- Rotational staffing models are gaining momentum and providing a valuable source of talent to the business
- Internal audit organizations are facing mounting challenges related to capacity and capability
- Audit report ratings are popular but present risks and challenges for internal audit

PwC 2007 State of the Profession Survey

2007 Trend: Pressures are building for continual focus on risk

Key trends – Pressures build for continual focus on risk

Inconsistency in Enterprise Risk Management is Still a Challenge

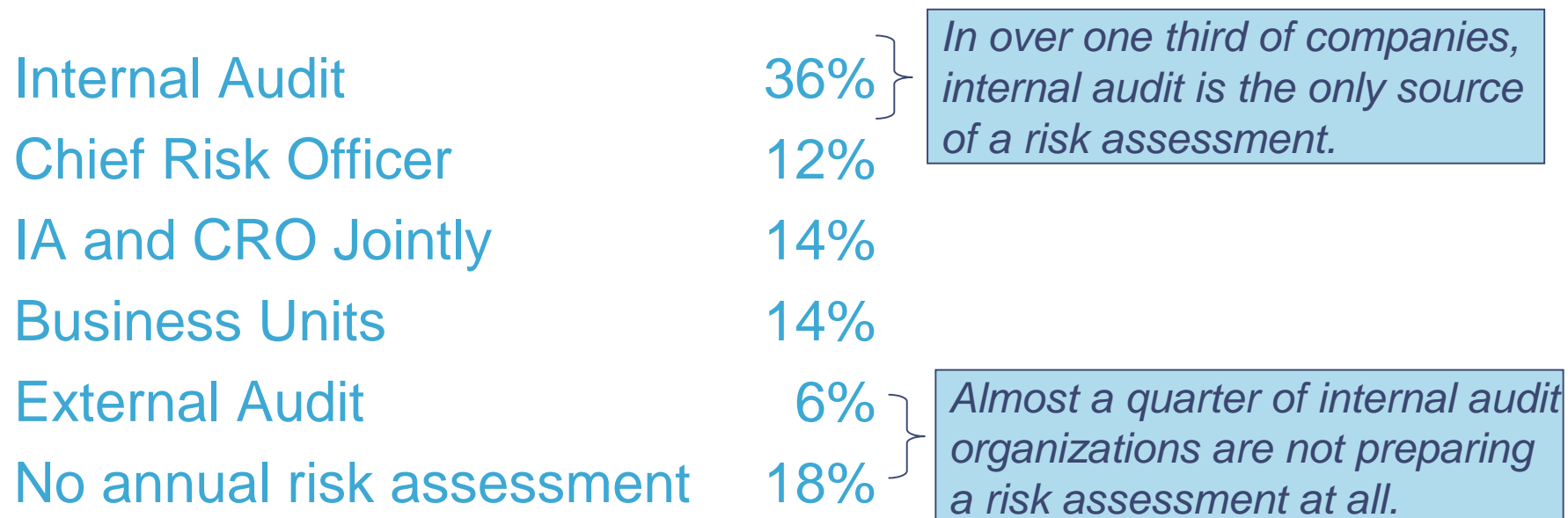
- Many internal auditors are uncertain about their roles in enterprise risk management
- The survey documented a lack of consistency in the way risk management is being practiced
- Implementation of risk management at many organizations is immature at best and chaotic at worst

Audit Committees are directing those responsible for the risk assessments to coordinate their efforts and deliver joint presentations on risk assessment results.

Key trends – Pressures build for continual focus on risk

Multiple Risk Assessments are Being Prepared Across the Enterprise

Responsibility for Conducting Annual Risk Assessments



Key trends – Pressures build for continual focus on risk

Multiple Risk Assessments

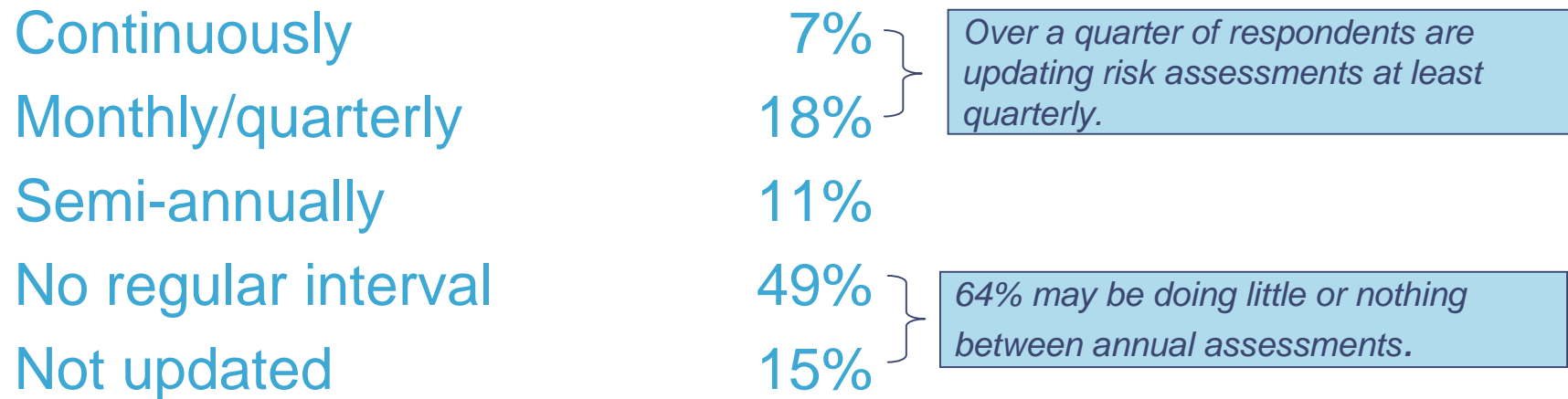
Are multiple enterprise-wide risk assessments developed by different groups within your company annually?



Key trends – Pressures build for continual focus on risk

Frequency of Assessment Updates

How often do you update or revise your risk assessment?



Key trends – Pressures build for continual focus on risk

Varying Levels of Assessment Confidence in Addressing Risks

Are you “very confident” that your internal audit coverage effectively addresses the following risks within your company:

Financial	64%
Compliance	49%
Operational	43%
Technology	33%
Fraud	29%
Strategic/business	20%

Respondents expressed higher confidence in sectors considered to be traditional areas of focus for internal.

PwC 2007 State of the Profession Survey

2007 Trend: Sarbanes-Oxley demands are stabilizing at a significant level

Key trends – Sarbanes-Oxley demands stabilize at a significant level

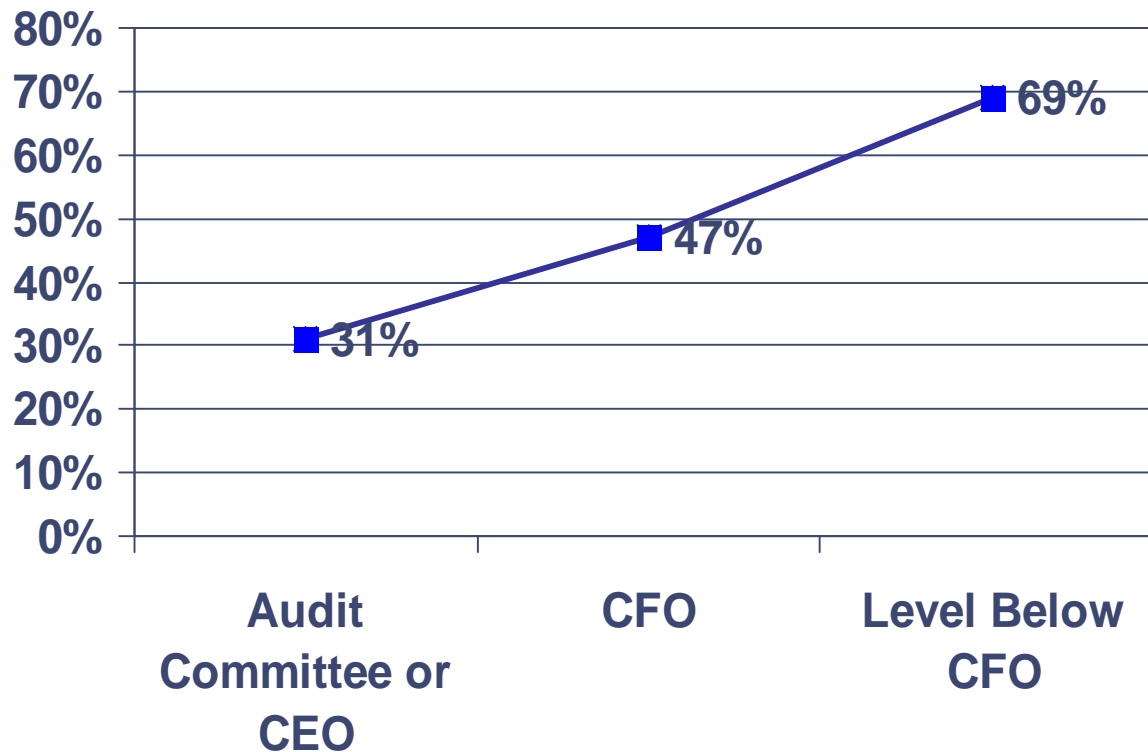
Resource Allocations Remain High

<u>Percentage of Resources:</u>	<u>2006 Estimated</u>	<u>2006 Actual</u>	<u>2007 Estimated</u>
100%	1%	5%	2%
75-99%	12%	16%	11%
50-74%	20%	20%	19%
25-49%	35%	31%	33%
<25%	31%	29%	34%
	33%	41%	32%

Internal auditors in the United States have been devoting a third or more of their time and other resources to addressing the requirements of Sarbanes-Oxley.

Key trends – Sarbanes-Oxley demands stabilize at a significant level

There is a High Correlation Between Internal Audit's Administrative Reporting Relationship and the Amount of Time



Survey data indicated a strong correlation between internal audit's administrative reporting relationship and the degree to which a company's internal audit resources are devoted to Sarbanes-Oxley compliance.

Key trends – Sarbanes-Oxley demands stabilize at a significant level

CAEs are Maintaining a Strong Focus on Section 404

- 56% are responsible for S404 project management
- 64% (45% of F500) indicated that Sarbanes-Oxley testing support is primarily being conducted under the direction of the CAE
- Management bears primary responsibility for testing at 36% of companies overall (55% of F500 respondents)

How can management provide audit committees with objective assurance that a company's Sarbanes-Oxley processes are being managed effectively when the internal audit function has responsibility for Sarbanes-Oxley compliance?

Key trends – Sarbanes-Oxley demands stabilize at a significant level

Continued Strong Focus on Section 404

Who handles most of the S404 testing?

	<u>Overall</u>	<u>F500</u>
Internal audit	34%	29%
Combination of internal audit & service provider	43%	42%
Non-internal audit personnel	20%	28%
Service provider personnel	3%	1%

At 77% of total respondents, and 71% of Fortune 500 companies, internal audit plays a major role in S404 testing.

PwC 2007 State of the Profession Survey

2007 Trend: Rotational staffing models are gaining momentum

Key trends – Rotational staffing models gain momentum and provide a valuable source of talent

There has Been Growth in Popularity of Rotational Staffing Models: However, There is Little Consensus as to Which Model Works Best

- More than 70% of Fortune 500 respondents use some form of rotational staffing for all or significant portions of their audit staffs
- 8% of respondents (13% of Fortune 500 respondents) use a pure rotational staffing model
- 43% of respondents (57% of Fortune 500 respondents) use a blend of rotational staffing and career positions
- 49% of respondents (30% of Fortune 500 respondents) said their staffs were made up entirely of career positions

Key trends – Rotational staffing models gain momentum and provide a valuable source of talent

Optimizing Rotational Models

Ideally, rotational programs will have:

- Executive level sponsorship and support throughout the organization
- Clearly defined criteria for recruits
- Established performance goals and metrics
- A duration of about three years
- Linkage to the organization's management development programs
- Shorter-term guest auditor programs
- Safeguards to ensure that auditors nearing completion of tenures are able to carry out their responsibilities objectively

PwC 2007 State of the Profession Survey

2007 Trend: Internal audit organizations face mounting challenges related to capacity and capability

Key trends – Internal audit organizations face mounting challenges related to capacity and capability

Internal Audit is Exposed to Mounting Challenges

- Greatest challenge is finding enough qualified talent to address the needs of the stakeholders
- Number of vacant positions being recruited for in 2007 (31%) is consistent with 32% overall for 2005 and 2006
- Also concern about the ability to address the competing priorities and ability to identify emerging risks
- New 404 guidance may alleviate staffing challenges in the years ahead

Most internal audit groups believe they are receiving adequate budgetary support from audit committees and executive management.

Key trends – Internal audit organizations face mounting challenges related to capacity and capability

Primary Challenges in the Year Ahead

Potential challenges for internal audit:			
	High	Med	Low
Ability to recruit necessary talent	37%	38%	25%
Ability to find right skills to provide adequate audit coverage	15%	51%	33%
Ability to find enough people with IT audit skills	28%	40%	31%
Difficulty navigating the competing priorities of stakeholders	12%	42%	46%
Ability to identify emerging risks	11%	52%	38%
Lack of an adequate budget to address the audit plan	12%	33%	54%

Internal audit is unlikely to experience budget challenges in the year ahead, but can expect to have trouble attracting and retaining the mix of talent needed to deliver effectively on stakeholder expectations.

PwC 2007 State of the Profession Survey

2007 Trend: Audit report ratings are popular but present risks and challenges for internal audit

Key trends – Audit report ratings are popular but present risks and challenges for internal audit

How Wide Spread is the Use of Audit Ratings?

- Increased focus on internal audit reports and findings
- Stakeholders are requesting clarity and prioritization of audit results
- Requests for CAE's to provide internal audit's assessment with respect to organizational controls
- Audits are viewed as an excellent source of information to help management understand and assess performance

56% of respondents – and 63% of Fortune 500 respondents – routinely include ratings on individual findings.

63% of respondents routinely include an overall rating to reflect audit conclusions – 75% for Fortune 500 respondents.

72% of respondents believe that ratings can lead to disagreements with management officials, and slow down the reporting process?

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Research Objectives and Methodology

- Objective
 - Identify forces and trends that will reshape Internal Audit over the next 5 years
- Areas of focus
 - Impact of business trends on Internal Audit
 - Composition and expectations Stakeholders
 - Internal Audit roles and responsibilities
 - Internal Audit organization and structure
 - Human resources practices
 - Working practices
 - Communications and reporting
 - Internal Audit use and leverage of technology
 - IT audit strategy
- Methodology
 - Survey of all Fortune 250 Chief Audit Executives
 - Twenty-five additional surveys of other selected thought leaders, academics and stakeholders
 - Direct interviews of 19 individuals representing a cross section of the survey population
- Respondents
 - 72 survey responses from CAEs representing F250 companies (29%)
 - 19 one-on-one interviews

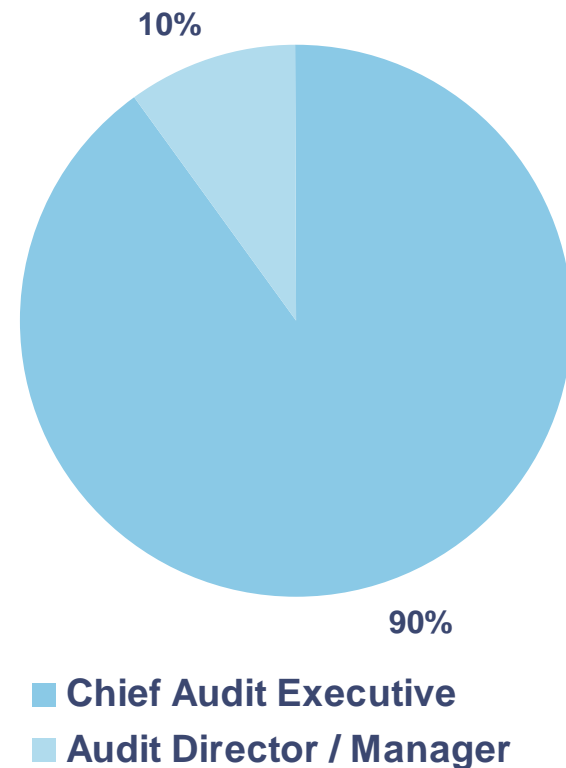
Summary of Research Results

Survey responses by industry and title (72 responses)

Industry

Energy, Utilities & Mining	21%
Financial Services	19%
Retail	11%
Consumer Products	10%
Healthcare	8%
Manufacturing	7%
Aerospace & Defense	4%
Automotive / Transportation	4%
Software / Technology	4%
Other	12%

Title



Two emerging views

Stay the Course

- Many respondents felt the fundamental mission and role of Internal Audit would remain largely unchanged over the next five years.
- We refer to this as the “**Controls-centric**” view.

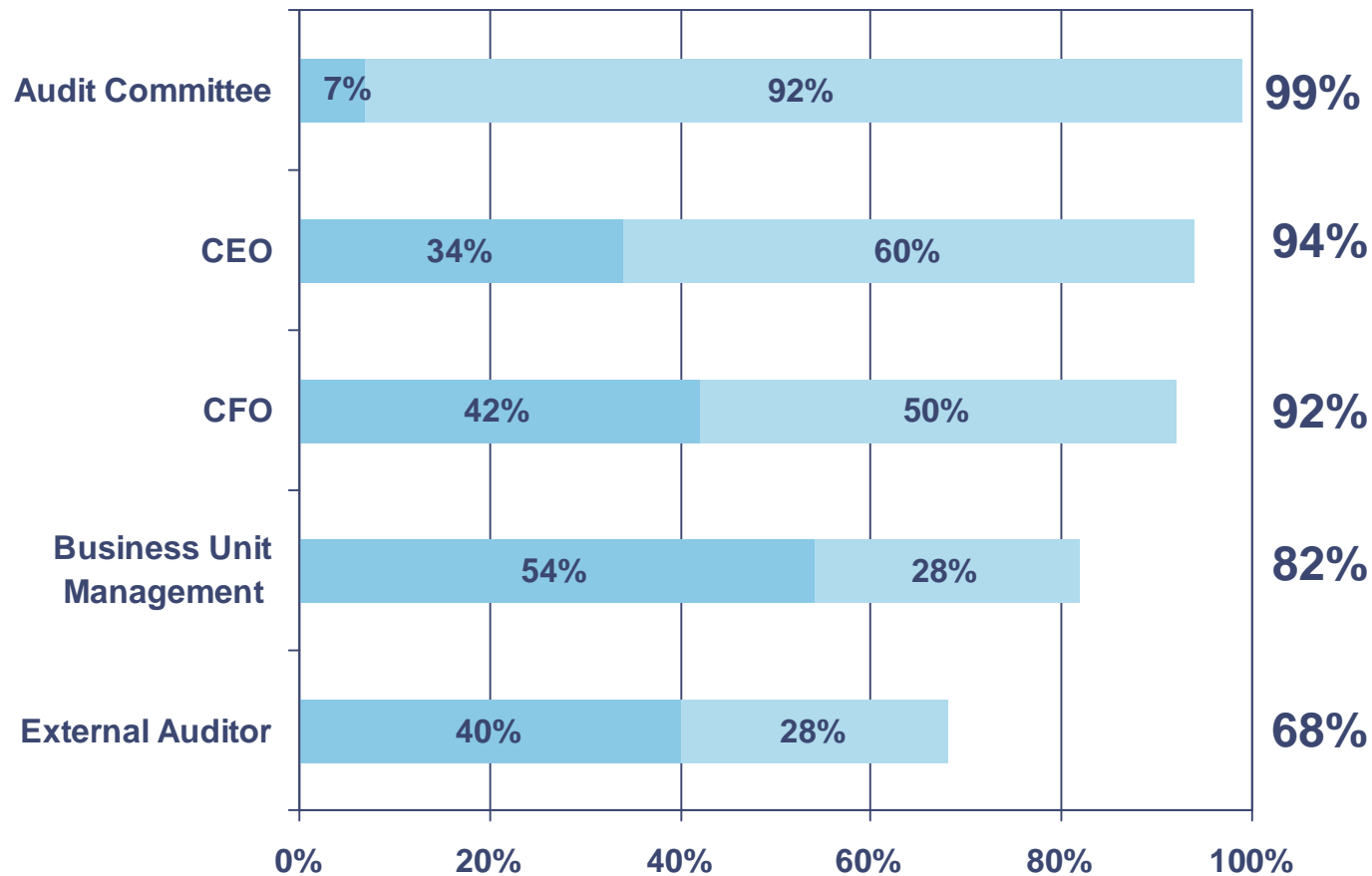
Dynamic Change

- Other respondents, particularly those we interviewed, saw fundamental changes in the mission and role of internal audit by 2012.
- We refer to this as the “**Risk-centric**” view.

Certain “macro trends” were recognized by both groups as having significant impact on Internal Audit by 2012.

Summary of Research Results

Survey results: Relative Importance of stakeholder groups



The Board and Management will continue to be the primary stakeholders of Internal Audit, but other risk and control functions will also be identified as stakeholders

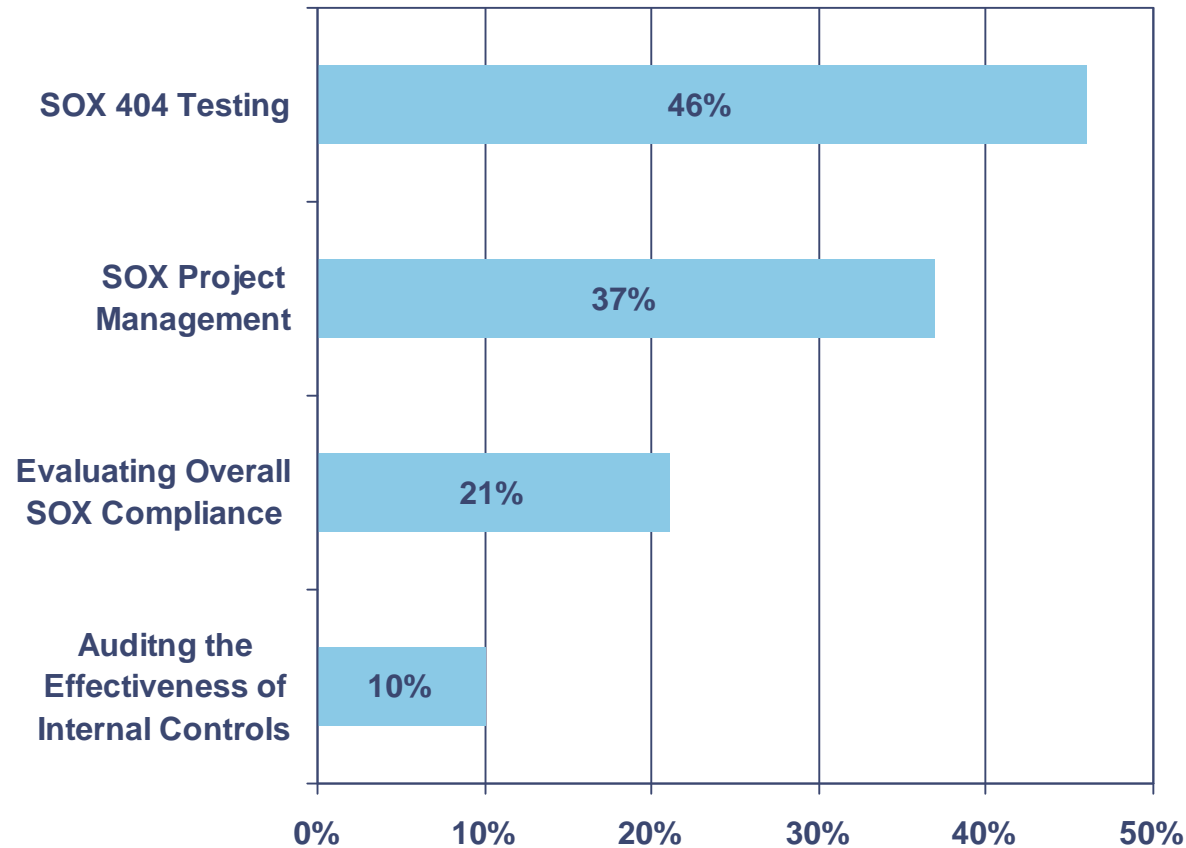
*Senior Executive,
Rating Agency*

■ Very Important
■ Extremely Important

Summary of Research Results

Survey results: Decrease or moderation of newfound roles and responsibilities

Areas of Decreasing Responsibility by 2012



Over the next five years there will be a flattening of SOX efforts. *Chief Audit Executive, Transportation Industry*

■ Much Less or Somewhat Less Responsibility in 2012

Summary of Research Results

Survey results: Skill sets that will be more important by 2012

- | | |
|---------------------------|-----|
| 1. Data mining & analysis | 89% |
| 2. Risk assessment | 76% |
| 3. Information technology | 72% |
| 4. Risk management | 70% |
| 5. Fraud detection | 69% |

Survey respondents indicating the skill set will be “far more important” or “somewhat more important” than today.

The ability to conduct data analysis is essential. *Chief Audit Executive, Healthcare Industry*

Integrating technology and the finance skill set is becoming more and more important. *Chief Audit Executive, Technology Industry*

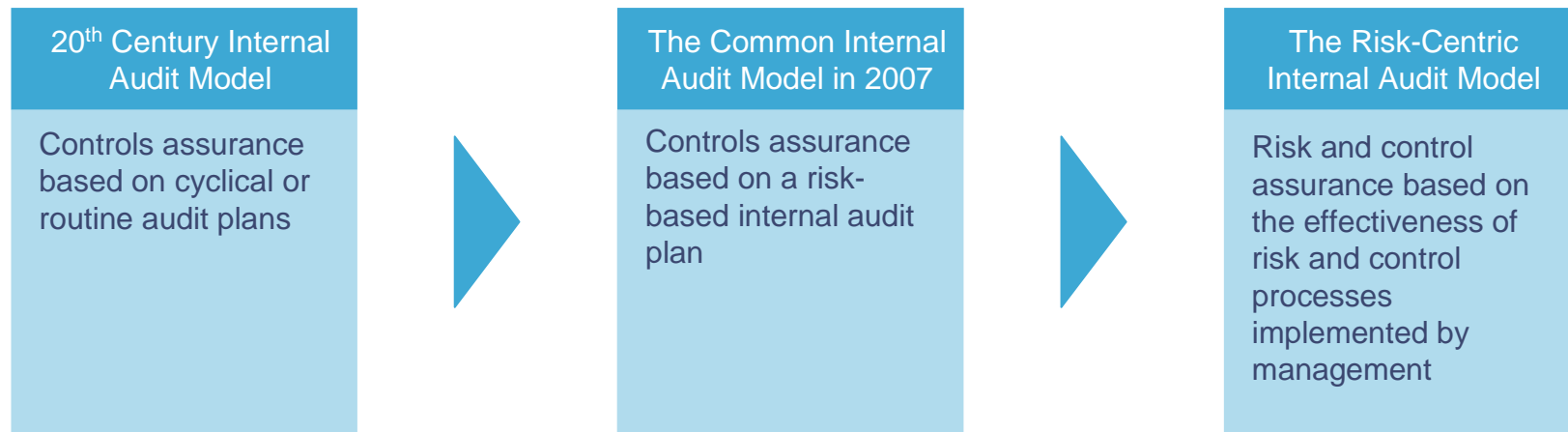
Sarbanes-Oxley has developed an Internal Audit culture of staff believing they could “stop thinking.” Internal Audit needs to get back to having business conversations, be better prepared, and have an understanding of what is going on in the business. *Chief Audit Executive, Consumer Products Industry*

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Internal Audit at a Crossroads

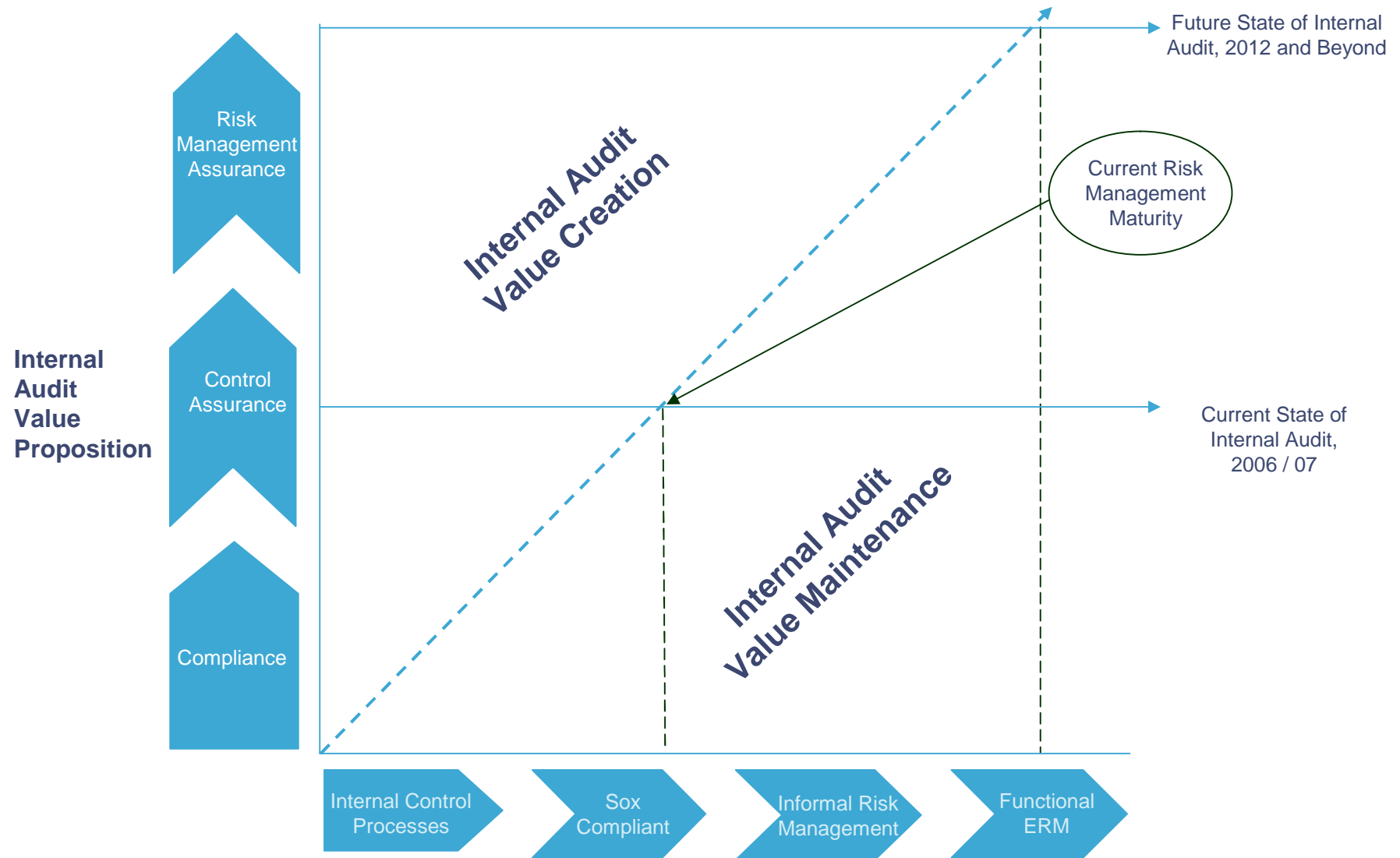
As companies move toward risk management, Internal Audit must also evolve – or risk a diminished value proposition



If the view (among stakeholders) grows that all Internal Audit does is test controls, then resource levels will have to come down. *Chief Audit Executive, Financial Services Industry*

Traditional internal auditing will probably diminish in value if the organization moves towards formal risk management. *Senior Executive, Rating Agency*

Value creation vs. maintenance



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Key trends PwC believes will reshape Internal Audit by 2012

- Changes in risk management
- Changes in Internal Audit roles
- Organizational and talent management trends
- Globalization
- Technology

Through analysis of both survey and interview data, PricewaterhouseCoopers believes these broad trends will drive change in Internal Auditing over the next 5 years.

Changes in risk management

- Companies are beginning to look at more comprehensive and formal approaches to risk management
- More than half of internal audit respondents believe an annual planning process focused on risk assessment will be more important in 2012
- Over 70 percent expect that either they or their company will conduct continuous or ongoing risk assessments
- 60 percent believe that continuous risk assessments will be leveraged in audit planning
- Interviews revealed a strong consensus that fraud risks will be more critical going forward

Changes in Internal Audit's Role

- Survey respondents believe Sarbanes-Oxley impact will decline – however, respondents believe other external and internal factors will influence internal audit's roles by 2012.
- Major trends having an moderate to strong impact on internal audit's roles and responsibilities include:
 1. Technology 95%
 2. New regulations 88%
 3. Risk management 87%
 4. Corporate governance 84%
 5. Ethics and compliance 77%

Changes in Internal Audit's Role - continued

- Areas of greatest projected increases in internal audit's responsibility include:
 1. Continuous auditing or monitoring 95%
 2. Auditing the ERM process 77%
 3. Auditing outsourced or off-shored operations 75%
 4. Fraud detection 66%
 5. Fraud risk assessments 66%
 6. Auditing executive comp and disclosures 65%
 7. Auditing operational efficiency/effectiveness 64%

Organizational and Talent Management Trends

- By 2012 respondents predict Internal Audit will report administratively as follows:

- Audit Committee	10%
- CEO	25%
- CFO	42%
- CRO/General Counsel	15%
- Traditional accounting and auditing skills expected to remain important – however, these skills alone will be too limited to meet the needs of many Internal Audit organizations
- 63 percent of respondents project an increase in the number of Internal Audit staff professionals by 2012 in areas such as IT; regulatory compliance; risk management; etc.

Globalization

- Interviewees believe globalization will have a significant impact on internal audit over the next five years
- As more companies expand operations outside of their “home country” borders, internal auditors will face a myriad of challenges:
 - Assessing risks in remote geographic locations
 - Understanding control or cultural environments in remote or developing markets
 - Obtaining staffing or resources to provide coverage
- When asked to describe Internal Audit organizational structure for global companies in 2012
 - Central function in home country 37%
 - Core function in home country with satellite operations 54%
 - Small operation in home country – predominant outside 8%

Technology

- Impact of technology over the next five years was a recurring theme from the research
- Participants anticipate major changes in what they audit and how they audit and the skills that will be needed
- 100% expect use of technology to increase
- IT capabilities expected to grow the most in importance:
 - Privacy-related risks 60%
 - Off-shored technology operations 60%
 - Automated controls 60%
 - ERP systems 53%
 - Network security 51%
 - Data warehouse controls 50%

Technology - continued

- Participants' anticipated deployment of IT strategies:

- Increase IT skill level of general internal audit staff 76%
- Acquire more sophisticated IT tools to address IT risks 68%
- Increase use of third-party experts 60%
- More integration of IT audit resources into non-IT teams 57%
- Deploy higher level more experienced IT auditors 54%

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Ten Imperatives for Success in Next Five Years:

1. Strive continuously for appropriate alignment and stature of internal audit within your company.
2. Develop and regularly update a formal strategic plan
3. Communicate continuously with key stakeholders
4. Ensure alignment of internal audit human resources strategies with enterprise and stakeholder needs
5. Maintain a continuous focus on enterprise risks and migrate toward a “risk-centric” value proposition.

Ten Imperatives for Success in Next Five Years:

6. Enhance IT audit skills and capabilities and continuously strive for an integrated approach to IT audit coverage.
7. Identify and implement technology solutions to enhance internal audit's efficiency and effectiveness.
8. Leverage the collective knowledge and expertise of internal audit through a formal knowledge management strategy.
9. Commit to continuous quality assurance and improvement.
10. Link performance measures to strategic goals.

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