



## The future of internal audit

Members of the Northeast Audit Committee Network (NEACN) met on September 22, 2011, in New York for their sixth meeting. They were joined by chief audit executives from several of their companies for a discussion about the future of internal audit, including ways that audit committee chairs and audit executives could deepen their relationship. Members were also joined by Gerry Dixon, Ernst & Young's Northeast Advisory Services managing partner, and Jennifer Rowland, a partner in Ernst & Young's Advisory Services practice. This document presents a summary of the key points raised during the meeting, along with selected perspectives that members shared before and after the meeting.<sup>1</sup> For a list of meeting participants, see Appendix 1, on page 13.

### Executive summary

After passage of the Sarbanes-Oxley Act of 2002, many traditional internal audit activities were pushed aside in order to comply with the internal controls documentation and testing required under Section 404. However, with Sarbanes-Oxley compliance now largely routine, many companies are considering how best to harness the skills and experience of the internal audit team. An audit executive remarked, *"There was once a vision for the audit department to be the guardrails for the organization. What's happening today is a move back to trying to get more out of the function."* The discussion covered three broad areas, which are outlined below and described in more detail on the following pages:

- **Internal audit is balancing traditional activities with more expansive endeavors** (page 2)

The mandated "baseline" for what internal audit must do at a company allows for significant leeway in how internal audit is deployed. Audit committee chairs and audit executives said internal audit's scope of activity depends on the needs of the organization and internal audit's resources and capabilities. Most meeting participants said internal audit's top priority is their core financial control requirements. Some felt that gaps in skills and resources constrain internal audit from getting involved in more operational and strategic activities. Even so, internal audit is playing a more active role in risk management, including auditing risk-management processes and ensuring the risk-management plan remains dynamic.

- **Internal audit is employing a variety of ways to enhance its effectiveness** (page 6)

Internal audit departments are actively managing the talent pool, cosourcing and outsourcing to address budgetary concerns and improve flexibility, building better relationships with the business units, and using evaluations to improve their performance. Audit committee chairs and audit executives said that advanced technologies, such as data mining and continuous auditing tools, could help them get more efficient, but because of a lack of resources, internal audit departments have generally been unable to take advantage of these tools.

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<sup>1</sup> *VantagePoint* reflects the network's use of a modified version of the Chatham House Rule whereby names of members and their company affiliations are a matter of public record, but comments made during the meetings are not attributed to individuals or corporations. Quotes in italics are drawn directly from comments made by NEACN members before, during, and after the September 22 meeting. Mr. Dixon and Ms. Rowland's comments are not italicized.



▪ **Audit committee chairs and internal auditors seek to deepen their relationship** (page 10)

Members and audit executives agreed the audit committee could help elevate internal audit's role in the company and help remove "roadblocks" with executives and the business units. However, several audit executives said unclear expectations from the audit chair and a lack of communication between audit committee and the internal audit staff can create barriers to a better relationship. Audit executives and audit committee chairs outlined a number of ways that they could improve communication, including having candid discussions about the role and the mandate of internal audit, and ensuring internal audit has a say in the audit committee's performance evaluation. For a list of questions that audit committees should consider about the future of internal audit, please see Appendix 2, on page 14.

**Internal audit is balancing traditional activities with more expansive endeavors**

New York Stock Exchange (NYSE) corporate governance rules require that "listed companies must maintain an internal audit function to provide management and the audit committee with ongoing assessments of the company's risk management processes and systems of internal control."<sup>2</sup> Mr. Dixon explained, "The baseline, according to the NYSE, requires that you have an internal audit function. There are some companies that have one internal auditor. And some companies have over 1,000 internal auditors. Internal audit is defined differently at each company." Members and guests agreed with one member who said, "This baseline for what an internal audit function must do is really a low threshold." An audit committee chair observed, "The mandate for internal audit is broad across companies and not consistently defined. It is also evolving. It's a fairly broad spectrum."

**Internal audit's scope depends on the company's needs**

The broad nature of the language in the aforementioned NYSE requirements allows for significant latitude in the scope of responsibilities covered by internal audit. Mr. Dixon remarked, "In some companies, internal audit is an extension of the external auditors. In others, it is an extension of management, and it is doing operational audits and it is auditing the strategic plan. It depends on the mandate." One audit committee chair said, "I have three different companies with three different audit plans. It is impossible to generalize about [internal audit's scope]." Audit executives also remarked on the differences in size and scope of their respective audit functions, noting that resources and organizational structures can have significant impact on internal audit's charter.

Some internal audit executives reported a challenge in "balancing different stakeholder needs" when developing and completing an audit plan. One said, "What audit means is different to different stakeholders. It's tough." Another audit executive said, "We have the things that we have to do from the audit committee's perspective, and then we have operations, sales, and other executives. It is a matter of getting a plan and the resources to address the needs of the different stakeholders." Audit executives noted that the audit committee itself is an important stakeholder whose priorities are not always clear to the internal audit

<sup>2</sup> New York Stock Exchange, *Final NYSE Corporate Governance Rules* (New York: NYSE Euronext, 2009), 13.



team; as one said, *“The audit committee blesses the [annual audit] plan, but that comes from me, not them.”* See page 10 for more on the audit committee’s relationship with internal audit.

### **The first priority for internal audit remains its core financial control duties**

In a recent Ernst & Young report, a survey of senior executives and directors found that “only 44% of respondents believe that Internal Audit is helping their organization achieve its business objectives. And fewer – 37% – say they involve Internal Audit in key business decisions and strategy.”<sup>3</sup> Outlining ways that internal audit can enhance its strategic value, the report advised, “In becoming a more essential advisor to the C-suite and the Audit Committee, Internal Audit should be involved in any strategic business investment to grow or improve the organization where a missed risk could hurt share price, market capitalization or earnings.”<sup>4</sup>

Audit committee chairs and audit executives agreed that there are often challenges associated with internal audit becoming more involved in *“value-adding activities,”* such as auditing whether the company is meeting objectives laid out in its strategic plan. Several audit committee chairs agreed with one who said that *“a focus on value-add sounds good in theory, but is quite difficult to implement in practice.”* Audit committee chairs and audit executives described two main reasons for this challenge:

- **A gap in skills and capabilities.** One audit committee chair said, *“When you are asking for people to audit the strategic plan, they better really know the business. You are no longer asking for internal auditors – you are now asking for [strategy consultants].”* Another added, *“Our internal audit skill set is exceptional, but it has its limitations. We are seeing the risk universe expand, and we don’t know anyone in internal audit who could address this.”*

Audit executives agreed that a mandate calling for more involvement in operational and strategic activities would demand more resources, which are often hard to come by: *“I never get the audit committee saying, ‘Do you need more money?’”* In addition, while one audit executive said he *“can fill a job in a week,”* most have trouble recruiting good people to take on the responsibilities their departments currently have; one said, *“I will go most of the year without a full headcount. I just can’t fill [open positions].”*

- **A risk of losing focus on traditional financial controls.** Audit committee chairs and audit executives were wary of internal audit playing a larger role in more operational and strategic activities because it could detract from their core compliance and financial reporting control duties. An audit executive said, *“If you focus on something [more expansive] and fail, there will be hell to pay.”* Another member commented, *“This operational and strategic activity sounds great, but internal audit’s core duties around compliance are what makes me sleep at night. Take care of that first, and then we can talk about the more expansive [activities].”* Audit executives agreed, with one noting, *“[Sarbanes-Oxley] is what allows us to be a publicly listed company. That creates value, and we shouldn’t belittle it.”*

<sup>3</sup> Ernst & Young, *Unlocking the Strategic Value of Internal Audit: Three Steps to Transformation* (Ernst & Young Global Limited, 2010), 1.

<sup>4</sup> *Ibid.*, 8.



### **Internal audit is selectively addressing some operational and strategic activities**

While internal audit may be limited in its resources and capabilities, audit committee chairs and internal audit executives agreed that internal audit can “*selectively get involved in some operational and strategic activities*” beyond its core functions.

Indeed, a proactive internal audit department can enable the company to absorb more risk, and elevate the company’s governance in the eyes of investors. Members and guests expanded on the benefits of a proactive internal audit function:

- **Giving management the confidence to take risks.** Mr. Dixon said, “*We had a client considering a major acquisition in a high-risk foreign country, and they were able to move swiftly and confidently because internal audit was so on top of all of the risks. That’s a real value-add.*”
- **Enhancing governance in the eyes of investors.** An audit committee chair said, “*To our investors, governance is of value. Our multiples depend largely on the way our company is governed, and internal audit is a key cog in that governance structure. Internal audit helps provide a level of confidence that the likelihood of surprises is much lower.*”

As a result, some audit committee chairs are encouraging their internal audit departments to be more proactive in certain areas, including the following:

- **Finding efficiencies throughout the organization.** One audit committee chair said, “*Internal audit can be a profit center. It is a great place to make money. A careful look at leases and other contracts can help save you a bunch of money. Also, your compliance and regulatory costs can go way down when internal audit gets involved.*”
- **Helping ensure the control environment overseas.** Members and audit executives said that as more companies expand their international operations, internal audit is playing a larger role in ensuring controls in these markets and raising awareness of regulatory obligations entailed by legislation such as the US Foreign Corrupt Practices Act and the UK Bribery Law. One audit committee chair remarked, “*Ten years ago, we were 100% domestic focused, and now we ... have a major footprint around the world. Internal audit has much more of a role in educating our people in the field overseas.*” Another audit committee chair uses internal audit to help reinforce tone at the top overseas: “*Given that a lot of risk has shifted overseas, I like to send internal audit abroad. I’ll tell them, ‘Go to South Africa. You may or may not find something there. But at least they will know that corporate headquarters is paying attention.’*”
- **Aligning audit work with the company’s strategic objectives.** One audit committee chair said, “*Most progressive [internal audit] functions are aligning their work with the business objectives of the company. They make sure they understand the overarching strategic objective that informs their specific projects.*”



For their part, audit executives said they don't want or need to be “*in-house consultants*,” but feel they can add value by auditing (not developing or owning) key processes, whether related to operations, new product development, new market entry, human resources, or even the annual strategic review. As one audit executive observed, “*The biggest blows to shareholder value are the strategic failures, where there is poor information or bad execution. Internal audit can provide a check on those processes.*” The audit executives said that the challenge is finding the balance between value-adding activities and required activities (given many are resource constrained) and “*getting a foot in the door*” with businesses units and management. Ms. Rowland said, “*Internal audit has to be the gatekeeper and the owner of process, and it is important that they find that balance.*”

### **Internal audit is taking a more active role in risk management**

One audit committee chair asked, “*In the whole framework of risks, what does internal audit do? Who do they work with? Who are their customers?*” All audit committee chairs and audit executives agreed that internal audit should not “*own*” the risk-management process, but described several roles that internal audit may play in risk management.

- **Auditing the risk-management process.** One audit executive said, “*Risk management is assigned to various managers of the company, and the real responsibility lies with the risk officer. But internal audit has a role in auditing that process.*” Another audit executive said, “*We have a [specific] role in the risk-management process: we audit the process of managing all of the risks, including fraud and bribery and third-party manufacturer [risks].*”
- **Gathering data to help evaluate risks.** One audit executive pointed out, “*There is a big difference between risk management and risk assessment. Any time people talk about risk management, auditors should shy away. Internal audit is supposed to be independent. In our charter, we are not supposed to take any managerial role.*” However, the executive continued, “*We lead an annual risk assessment every year, which addresses financial, operational, business, IT, and fraud risks. We survey people across the organization and complete an audit plan. Then we take every person we surveyed, and we meet individually for a 30-minute session in which we provide them with one composite score with all the risks from those categories, and it will also show how they [rated those risks] this year versus how they [rated them] the year before. It will show their perception of how the risks have changed.*”
- **Challenging the audit committee’s risk analysis.** In a recent issue of *InSights*, an internal audit executive remarked, “*You need to challenge the audit committee members to leverage their experience to think about [business model] changes and how they could introduce new risks ... An old audit plan over a dynamic business does not work.*”<sup>5</sup>

<sup>5</sup> Ernst & Young and Tapestry Networks, “[Internal Audit’s Evolving Role: A Proactive Catalyst of Business Improvement.](#)” *InSights*, April 2011.



### A changing approach to enterprise risk management

One member remarked, *“The risks that the company is facing are getting so big and sophisticated”* that ultimate risk-management responsibility may be beyond internal audit’s capabilities; as a result, members and guests reported a trend toward *“chief risk officers in commercial companies.”* One member said, *“We created a new position for a very senior executive to lead risk management in the company. Internal audit reports into him, and he reports to me and the CFO. He crosses divisional and product lines. Before he came aboard, no one was looking at the risks across the organization and bringing it together like that.”*

Another member said, *“We created an enterprise risk management council. There are 10 people involved, including the general counsel and some senior executives, including the CFO and the head of HR. Internal audit reports to the chair of that committee. I like to dial in to their conference calls just to listen to what is going on.”* Members said this approach would allow internal audit to audit the risk-management process at their companies, but leave them free of overall responsibility so they could focus on their core duties.

### Internal audit is employing a variety of ways to enhance its effectiveness

Given the expanding risk universe that companies are confronting, and the budgetary concerns that internal audit departments face, audit committee chairs and audit executives said they are increasingly seeking ways to *“get more out of the department.”* Meeting participants articulated several ways that internal audit departments are enhancing their effectiveness:

1. Actively managing the talent pool
2. Cosourcing and outsourcing internal audit activities
3. Building trusting relationships with the business units
4. Using evaluations to enhance internal audit’s effectiveness

Audit executives also reported that advanced technology tools, such as data mining and continuous auditing software, may one day help make their processes more efficient, but most internal audit departments rely on traditional software tools such as Microsoft Excel and Access because they are resource constrained.

#### 1. Actively managing the talent pool

An audit executive said, *“If you want to take on these value-adding projects, you need the resources to do that. It is resource-dependent.”* Audit committee chairs and internal audit executives agreed that *“there has been a real [increase] in the capabilities and in the skill set of new internal audit talent”* at the top of the internal audit function. One audit committee chair said, *“We brought in someone who is very senior to lead our internal audit function. It was important that this person was very experienced and also had deep*



*knowledge of our business.*” Larger internal audit departments in particular are increasingly recruiting from a broader talent pool. An executive interviewed in a recent issue of *InSights* said, “We now look for more variety in our people [in internal audit], including engineers, scientists, management consultants, and people with change management experience.”<sup>6</sup> In addition, internal audit departments are increasingly hiring auditors with a greater level of academic experience. According to a 2010 Institute of Internal Auditors (IIA) survey, “Of the 2010 respondents, 49.7 percent have earned a master’s degree or graduate diploma compared to 41.1 percent in 2006.” The survey said, “It is clear that there is a major shift toward earning a graduate degree among internal auditors.”<sup>7</sup>

Audit executives said their departments manage their staff according to their budget and the needs of the organization. Meeting participants discussed two different approaches:

- **Rotating talent in and out of internal audit.** One audit executive said, “*Our whole group is transitional, including me ... If we send internal auditors out to the business, we have champions of internal audit in the business. That’s a win for internal audit, and a win for the company.*” An audit committee chair remarked, “*We have brought in people from the businesses to spend some time in audit. It’s a good opportunity to learn different areas of the business from a new perspective.*”
- **Retain highly experienced staff.** In companies with limited resources devoted to internal audit, staff turnover is a significant risk, so they typically recruit experienced auditors: “*We have experienced auditors because we can’t afford high turnover. We only have six auditors. We find ways to keep the job challenging and rewarding for them over time.*”

Some participants suggested a hybrid approach. One audit committee chair commented, “*I think you need a mix of people who have been and will be in internal audit for a long time and people who will be rotating out.*” An audit executive said that internal audit departments should keep these two models in mind when creating career development plans for internal auditors: “*You have to offer two tracks to new auditors: one, they can grow as an auditor within the organization; two, they have an ability to move into the organization. You have to put them on the right projects so they have these dual opportunities and get visibility in the organization.*”

## 2. Cosourcing and outsourcing internal audit activities

Of the respondents in the abovementioned Ernst & Young survey, 77% considered cosourcing to be a viable business option for their internal audit function, either as a short- or long-term solution.<sup>8</sup> Members and audit executives noted that companies might choose cosourcing and outsourcing for several reasons:

- **For budgetary reasons.** Some companies outsource or cosource specific portions of the audit function because it is cost-effective. One audit committee chair said, “*[Cosourcing] works, especially in larger companies. It allows [the internal audit department] to be more efficient.*”

<sup>6</sup> Ernst & Young, “[Internal Audit’s Evolving Role](#).”

<sup>7</sup> Institute of Internal Auditors, [Characteristics of an Internal Audit Activity](#) (Altamonte Springs, FL: Institute of Internal Auditors, 2010), 7.

<sup>8</sup> Ernst & Young, [Unlocking the Strategic Value of Internal Audit](#), 9.



- **To leverage specialized expertise.** Meeting participants generally agreed that some parts of the audit plan can be impractical to source internally because they require such specific expertise. One audit committee chair said, *“So many companies run such large portions of their business on a technology platform, and this technical capability is not easy to find. We’ve outsourced that in the past because it is not easy to find this expertise in so many different systems.”* Another member added that third-party providers have *“tons of resources – whether we need to look into supply chain, marketing, or anything else, we can tap those resources and also their knowledge of best practices.”*
- **To provide flexibility.** A participant in the aforementioned issue of *InSights* said, *“One reason I did more cosourcing was for flexibility. Because I was doing a dynamic audit plan, I had to bring in people who knew that part of the business. I wanted the flexibility to bring in people when I needed them and then send them back.”*<sup>9</sup>

### 3. Building trusting relationships with the business units

An audit committee chair remarked, *“Internal audit is a hard [job]. You have to look at your role as being supportive to the business, and not as a policeman. When it is working well, you see the people within the company coming to internal audit with questions.”* Audit executives noted the challenge in finding this balance between being partners to the business units and objective auditors. One audit executive observed, *“[Finding that balance] is one of the trickiest parts of the job. You really have to be careful to maintain your independence.”*

Audit executives cited several ways they could help build better partnerships with the business units:

- **Build better personal relationships.** An internal audit executive remarked, *“The challenging part for me is that because I am so immersed, I don’t interact enough with the various business units on a regular basis, just to ask, ‘What’s going on in your world today?’ My challenge is to get out and do more of it.”* An internal audit executive said these efforts require the courage to *“step out of your comfort zone. You have to challenge yourself and say, ‘I need to do more to foster those types of relationships with different aspects of the business.’”*
- **Demonstrate a deep knowledge of the business.** One audit executive said, *“Do we have the expertise to go into the business and work with the business units? My experience is that we have to prove ourselves. The business units don’t naturally think of auditors as business people.”*
- **Demonstrate flexibility.** Another audit executive said, *“You have to demonstrate a willingness to work with the business units. For example, there have been things that we have found in audits that have not been that significant, and we decided not to put them in a report. The business units really appreciate that. No one wants to see a report with 50 findings, 25 of which are nits.”*

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<sup>9</sup> Ernst & Young, [“Internal Audit’s Evolving Role.”](#)



#### 4. Using evaluations to enhance internal audit's effectiveness

Members and audit executives agreed that reviewing internal audit's activities against the annual audit plan is a key part of the function's performance assessment. Beyond that core metric, audit executives are keen to ensure continuous improvement. Audit committee chairs and audit executives outlined a number of ways they benchmark the performance of their internal audit departments.

- **Surveying the auditees.** One audit executive said, *"We are doing a survey after every audit to get real-time feedback. We ask the auditees, 'Were we responsive? Did we demonstrate a knowledge of the business?'"*
- **Measuring outcomes of the audit.** An audit executive suggested asking, *"Are our recommendations being implemented? Are we changing behaviors?"*
- **Tracking inbound requests from management and the business units.** One audit executive said, *"How many times does the phone ring? If we're getting requests for assistance, not just people calling with problems, it's an indication [the businesses] see us as a partner."*
- **Soliciting feedback from the external auditor.** An audit committee chair said, *"We ask our audit partner to help us evaluate the [internal audit] function and the people. [The external auditors] see a lot more than just [our company] and can provide some helpful insights."*
- **Peer reviews.** The IIA lists a periodic external quality assessment, or peer review, as one of its international standards for the professional practice of internal auditing, and it encourages companies to conduct these assessments once every five years.<sup>10</sup> While some audit executives said they were concerned about the cost of these peer reviews, one audit committee chair said, *"The peer review was worth its weight in gold because we were able to benchmark best practices and we learned some things we didn't know."*

#### Resource constraints limit audit executives' use of technology-based tools

Audit committee chairs and executives have noted there is a growing arsenal of new technologies to assist internal audit, including audit analytics and continuous monitoring services.<sup>11</sup> However, these advanced technologies are still a *"mystery"* to most audit committee chairs, and most audit executives reported they still rely mostly on Microsoft products, such as Excel and Access, for core tasks within the function. The audit executives said that disparate enterprise systems are a problem for implementing data mining tools, and with limited resources, audit executives said *"there are huge costs and unknown benefits with advanced technologies."* As a participant in the recent edition of *InSights* observed, *"We've been trying to perfect continuous auditing for 20 years, and trying to maximize the effectiveness of data analytical tools for years as well, and it is still in its infancy. There is no magic bullet. It comes down to the quality of the people on the staff."*<sup>12</sup>

<sup>10</sup> Institute of Internal Auditors, ["The External Quality Assessment Process,"](#) 2010.

<sup>11</sup> Ernst & Young, ["Internal Audit's Evolving Role."](#)

<sup>12</sup> [Ibid.](#)



Indeed, as one audit executive explained, the quandary most internal audit departments face is budgetary: *“It’s a choice – do you get the technology or another resource? The problem with smaller departments is that training and using these technologies takes significant resources. Am I adding value by spending fifty percent of my time managing a tool?”* Several audit executives said they partner with their firm’s IT department or enterprise risk management staff as a way to upgrade technology when budgets and skilled resources are limited. Others said they leverage the work that the external audit firm does in data mining on journal entries.

### **Audit committee chairs and internal auditors seek to deepen their relationship**

Audit executives agreed that, as one said, *“The audit committee’s support [for internal audit] really is critical in allowing us to do our jobs.”* Another audit executive said, *“The audit committee can go to management and say, ‘I really value internal audit. They are my eyes and ears ... If I go to the CIO, he will know to take the conversation more seriously after he knows the audit committee takes it seriously.”* According to the IIA, *“Audit committee members must play an active role in supporting the independence of internal auditing and ensuring it has enough resources to provide the appropriate level and quality of information.”*<sup>13</sup>

Audit committee chairs and internal audit executives said stronger relationships can help enhance the control environment of the company, but identified two main barriers toward a better relationship:

- **Not enough communication.** Prior to the meeting, one audit committee chair asked, *“Are internal auditors clear on what the audit committee’s expectations of them are?”* During the meeting, several audit executives said the audit committee’s expectations could be clearer. One said, *“[The audit committee] assumes that because we are in the role of internal audit we already know what is expected of us. But we want to know what is really on their minds. That’s the hard part. I’ll ask the audit committee chair, ‘What are you thinking about today?’ And they tend to speak generically.”* Another audit executive said, *“Their expectations of us are so broad. They say they want the company to be getting value from internal audit. That’s so general.”*
- **Internal audit’s administrative reporting structure.** Most audit executives report to the CFO or another senior executive, such as the general counsel or chief risk officer, and have a dotted-line relationship with the audit committee. Audit executives said this reporting structure can complicate their relationship with the audit committee. One audit executive said, *“The CFO determines my compensation. So do I care what the audit committee chair thinks about me? Yes. But I care what the CFO thinks more.”*

### **Mechanisms for improving the relationship between the audit committee and internal audit**

Audit committee chairs and internal auditors discussed a number of ways they could improve the lines of communication between their respective entities:

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<sup>13</sup> Institute of Internal Auditors, *Internal Audit Standards: Why They Matter* (Altamonte Springs, FL: Institute of Internal Auditors, 2005), 2.



- **Spend more time together.** Some audit committee chairs acknowledged their relationship with their audit executives was “*perfunctory*,” and that they felt “*guilty*” about how little time they spent with their audit executives. For their part, the majority of audit executives said they don’t have enough interaction with their audit committee chairs, typically only once a month or less. Many audit committee chairs said they don’t have any interaction with the staff below their internal audit heads. In contrast, however, one audit committee chair meets with the entire internal audit staff every 18 months, a practice that other members said they might adopt. In addition, one member said, “*I pick up the phone and call my [audit executive] whenever I have a question. We also meet for lunch sometimes informally, just to touch base.*”
- **Have discussions about the role that the audit committee foresees for internal audit.** Audit executives said they would like to know their audit committee chairs’ views on the questions, “*How can [we] make an impact for the organization? Are we a pipeline for talent? How can we help change behaviors?*”
- **Internal audit should feel empowered to proactively approach the audit committee.** One audit committee chair remarked, “*If internal audit doesn’t think we are [aware of something], they should pick up the phone and call us.*” However, another audit committee chair asked, “*How do you assess how internal audit feels empowered? They must be empowered to pick up the phone and call the audit committee chair with a concern in the middle of the night. If they don’t feel like they can do that today, we need to discuss why not.*”
- **Audit chairs could engage the board and senior management about the chief audit executive’s relative position and compensation.** Audit committee chairs said the audit committee is not well suited to determining compensation for their audit executives, as they are in an “*oversight role*”; however, one audit committee chair said, “*It’s our responsibility as audit chairs to have a discussion about the head of internal audit’s position and title with the board and the executive team. It is a big deal whether someone is a vice president or a director. And you can have a discussion about range of salary.*”
- **Internal audit could participate in the audit committee’s performance review.** One audit executive described how internal audit is involved in the review process at his company: “*We are surveyed yearly and asked about how the audit committee is performing. That is baked into their evaluation. We are giving the audit committee feedback.*”

## Conclusion

Regardless of its scope, internal audit can provide significant value. Mr. Dixon said, “*There is a deterrent aspect to internal audit. How do you measure the value of a lighthouse?*” Audit committee chairs said that internal audit is “*our eyes and ears in the organization*,” and the audit committee needs clear, timely, comprehensive information from internal audit in order to discharge its oversight responsibilities. As one audit executive said, “*The advantage internal audit has over every [other] department is that we get a chance to talk to everyone, from the most junior employees to the CEO. We are the rare group that has the pulse of what is going on throughout the organization.*”



However, members and guests acknowledged the “*difficult role*” that internal audit has: with dual reporting lines to the CFO or another executive and to the audit committee, and a mandate to “*play the cop and also be seen as a partner to the people in the business,*” internal audit is often viewed with suspicion and internal auditors may find themselves without a true champion in the business.

Audit committee chairs agreed with one who said, “*We really appreciate what internal audit does, and we are happy to have them.*” Indeed, several audit committee chairs praised internal audit’s work in finding efficiencies and promoting the control environment throughout the company. However, audit executives said they need more support from the audit committee with business unit leaders and executives. Audit committee chairs agreed with one, who said, “*We should start asking ourselves, ‘What we can do to give internal audit more support?’*”

## About this document

The Northeast Audit Committee Network is a group of audit committee chairs drawn from leading companies committed to improving the performance of audit committees and enhancing trust in financial markets. The network is convened by Ernst & Young and orchestrated by Tapestry Networks to access emerging best practices and share insights into issues that dominate the new audit committee environment.

*VantagePoint* is produced by Tapestry Networks to stimulate timely, substantive board discussions about the choices confronting audit committee members, management, and their advisers as they endeavor to fulfill their respective responsibilities to the investing public. The ultimate value of *VantagePoint* lies in its power to help all constituencies develop their own informed points of view on these important issues. Anyone who receives *VantagePoint* may share it with those in their own network. The more board members, members of management, and advisers who become systematically engaged in this dialogue, the more value will be created for all.

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## **Appendix 1: meeting participants**

The following members of the network were present at the meeting:

- Gail Deegan, Audit Committee Chair, EMC
- Nick DiPaolo, Audit Committee Chair, Foot Locker
- Dave Flaschen, Audit Committee Chair, Paychex
- Mary Guilfoile, Audit Committee Chair, Interpublic Group
- Bill Jennings, Audit Committee Chair, Silgan Holdings
- William Joyce, Former Audit Committee Chair, CVS
- Nancy Leaming, Audit Committee Chair, Biogen Idec and Hologic
- Bruce Maggin, Audit Committee Chair, PVH Corp.
- Doug Maine, Audit Committee Chair, ATK and Rockwood Holdings
- Brian McAuley, Audit Committee Chair, United Rentals
- Gus Oliver, Audit Committee Chair, Scholastic
- Ken Reiss, Audit Committee Chair, Harman International
- John Ryan, Audit Committee Chair, Cablevision
- George Zoffinger, Audit Committee Chair, Virgin Media

Internal audit executives present at the meeting included the following:

- Matt Buza, Vice President, Internal Audit, Scholastic
- Jeffrey Gibbs, Vice President, Internal Audit, Biogen Idec
- Michael Lewis, Vice President, Internal Audit, Hologic
- Eric Mertz, Vice President, Internal Audit, United Rentals
- Sean Miller, Director of Internal Audit, Paychex
- Jim Presser, Senior Vice President, Internal Audit and Compliance Assurance, Cablevision
- Andy Shaw, Director of Internal Audit/SOX, Rockwood Holdings
- Chet Simon, Vice President, Internal Audit, Harman International
- Bob Smorol, Group Vice President Internal Audit & Security Administration, PVH Corp.

In addition to Mr. Dixon and Ms. Rowland, Ernst & Young participants included the following:

- Scott Halliday, Northeast Sub-Area Managing Partner
- Linda Lam, Northeast Sub-Area Assurance Managing Partner



## **Appendix 2: questions for audit committees and internal audit executives**

- ?** How broad should internal audit's scope of responsibilities be, beyond its core focus on financial and process controls?
- ?** What is the most appropriate role for internal audit to play in enterprise risk management at your company? Why?
- ?** How can companies ensure internal audit keeps the right balance between assurance responsibilities and operational improvement activities? What role should the audit committee play?
- ?** How are internal audit departments changing their structure and/or personnel?
- ?** What skills and experience make for a strong internal audit department? How can companies attract, retain, and develop this new talent?
- ?** How does your company make use of outsourced or cosourced internal audit services? What benefits and drawbacks have you experienced?
- ?** What new and emerging technologies do you believe will prove most useful in enhancing internal audit's effectiveness?
- ?** What approaches work best to develop effective relationships between internal audit and the business units?
- ?** What are the best mechanisms for assessing the overall value that internal audit brings to the company?
- ?** How has internal audit's relationship with the audit committee changed in recent years? How do you envision the relationship three years from now?
- ?** What steps can or should the audit committee take to ensure that internal audit remains well respected and independent of management?