Internal audit's evolving role: a proactive catalyst of business improvement

Executive summary

Internal audit is undergoing its second transformation in a decade. After the passage of the Sarbanes-Oxley Act (SOX) in 2002, many traditional internal audit activities were pushed aside as internal audit staffs were redeployed to help their companies comply with the documentation and testing of internal controls required under Section 404. As one internal audit executive said, “Internal audit was co-opted to help with SOX work, and a lot of internal audit functions lost their way.” However, now that compliance with Sarbanes-Oxley requirements is largely routine, many companies are considering how best to deploy the skills of the internal audit team. An internal audit executive said, “SOX is well embedded, and internal audit is free again.”

In that context, Tapestry Networks investigated the evolving role of internal audit by speaking with more than two dozen audit committee chairs of Fortune Global 500 companies and 17 leading internal audit executives from global companies. The result is the current issue of InSights. Key findings center on internal audit’s focus, its effectiveness and the importance of support from the audit committee.
- **Internal audit needs to focus on the most value-added activities** *(page 4).* Research participants agreed that internal audit's role now extends beyond financial controls matters. It is playing a more prominent and proactive role in non-financial reporting – for example, in sustainability reporting – and it has focused its energies on catalyzing the company's risk discussions and auditing those processes. It has taken on a much broader role vis-à-vis emerging risks in the areas of information technology (IT), mergers and acquisitions (M&A) and compliance and corruption. Finally, internal audit's role is increasingly advising companies on governance processes and audit committee effectiveness. One internal audit executive summarized the increased role: "I look at everything in the company. I provide assurance to the audit committee that the company is being managed properly. Our mandate is broad, and we go everywhere."

- **Internal audit needs to enhance its effectiveness** *(page 8).* As the scope of the internal audit role has broadened, internal audit departments have been taking a number of steps to boost their performance. They are actively recruiting talent from a wider variety of backgrounds, including engineering and change management. They are using co-sourcing to fill skill gaps and manage costs, and they are leveraging advanced technologies to cover more areas more quickly. They are also investing more time and energy in building strong relationships with their colleagues in management and with the external auditors.

- **Audit committees need to guide and support internal audit more actively** *(page 12).* If internal audit is to be successful, the audit committee's support is imperative. Internal auditors want a clearer mandate and more visible support within the company from the audit committee. They also recognize that the audit committee has to ensure that internal audit remains independent and is staffed appropriately, and they know the audit committee needs better metrics to assess the value that the function adds to the company. Passive oversight of internal audit is no longer an option.
Internal audit needs to focus on the most value-added activities

Internal audit is playing a more prominent and proactive role in non-financial reporting matters, risk management and key emerging risks. Research participants agree that, as one internal audit advisor said, “Internal audit is now seen as an enabler of business performance. Internal audit can help make the business better and help the business go faster rather than slow it down.” A recent survey by the Institute of Internal Auditors (IIA) found that “in the next five years, the focus of internal audit activities will differ significantly from current practice ... auditors will place less emphasis on operational and compliance audits, auditing of financial risks, fraud investigations and evaluation of internal controls.” Additionally, participants noted internal audit has a greater advisory role in governance matters.

More involvement in non-financial reporting matters

Internal audit's role is extending beyond financial reporting controls to include audits of non-financial information and the controls surrounding the production of this information, notably in the areas of sustainability reporting and non-financial communications:

- **Sustainability reporting.** Companies are facing a host of pressures to comply with myriad complex sustainability reporting standards, and there are increasing concerns about the accuracy of the information in sustainability reports. As sustainability moves up the audit committee agenda, internal audit is taking a leading role in validating the information submitted for sustainability reports: “We have people from internal audit and legal spot-check using the same method as a financial audit. We ensure that the environmental performance and good deeds are credible.”

- **Non-financial communications.** Key stakeholders, such as investors and analysts, are paying increasing attention to non-financial communications to the marketplace, such as press releases, data on key operational performance metrics and earnings guidance. “Audit committees should decide with management what are the few key performance indicators that talk to the long-term value of the company, and they should see how management communicates them to the market,” noted an advisor in an earlier issue of *InSights*. Internal audit could play a key role by providing the audit committee with an assessment of the quality of the processes and controls used to generate this information.

A more focused role in the risk process

Observers note that “perfecting internal audit’s role in [risk] is still more art than science.” Internal audit took ownership of risk management when enterprise risk management (ERM) processes were still in their infancy, but as the processes matured, risk management became a management priority. Internal audit is now more focused on auditing the risk process and acting as a “risk catalyst,” leveraging its holistic perspective on the company’s key risks to initiate and influence risk management discussions at the management level. One internal audit executive said, “Internal audit is starting and leading conversations. While we don’t ‘own’ risk, we have an enterprise-wide purview, and we are well positioned to be a risk catalyst.”

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3. Ibid., 11.
More specifically, internal audit often undertakes the following tasks:

- **Managing the risk identification process.** An internal audit advisor said, “Internal audit can be very good at helping to look for and eliminate redundancies in risk coverage. Internal auditors are playing the project management office (PMO) role on risk committees — they are bringing together various risk functions in the same room to make sure parties are organized, and they are capturing key risks in the organization.”

- **Ensuring the risk analysis is dynamic.** Internal audit asks the difficult questions regarding how the company’s evolving business model affects its risk profile. An internal audit executive said, “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.”

- **Auditing the ERM process.** One internal audit executive described internal audit’s role as the “auditor of the risk process” by saying, “We’re not owners of risk management; that would be wrong. But we do facilitate the year-end process. We are on the administration of ERM processes. There is a risk management committee, and they own that process, but we audit their processes.”

### A sharper focus on emerging risks

An internal audit advisor said, “Internal audit has always been involved in financial programs and compliance; now internal audit is getting involved in operational and strategic areas, such as major capital programs or company-wide initiatives.”

Participants described internal audit’s increased role in several key emerging risk areas facing companies:

- **IT risks.** Innovations in IT, such as cloud computing, the explosion of social media and mobile computing, have introduced major business risks for companies. A recent Ernst & Young survey on information security found that “60% of respondents perceived an increase in the level of risk they face due to the use of social networking, cloud computing and personal devices in the enterprise.” Internal audit is playing a significant role in testing companies’ IT systems and staff. One audit committee chair said, “[You have to] make sure IT is part of the internal audit plan and [internal audit is] focusing on the right things.” Another audit committee chair provided an example of how internal audit proactively seeks out ways to mitigate the company’s IT-related risk: “One internal auditor was a conscious hire. He’s become a central thinker on a lot of these IT issues. For example, he did an inventory of IT devices around the country just trying to get a handle on these personal devices. At a minimum, we’ve got to figure out what kind of policy we need. When things are happening so fast in real time, you don’t really tend to think about that.” Internal audit’s role extends to IT systems implementation also. An Ernst & Young survey on internal audit noted, “There is a tremendous amount of risk associated with an enterprise-wide systems implementation. Internal audit should have a seat at the table from the beginning to help identify the risks and to provide controls consultation.”

- **M&A risks.** An internal audit executive said, “More and more internal audit functions are finding they ... can have an influence from the beginning of the M&A process. They can do a readiness assessment. They can help understand and monitor risks, and make control recommendations.”

- **Major new products risks.** The Ernst & Young internal audit survey noted that if a company is launching a new product, internal audit “can provide the right risk and controls analysis to help the company avoid recurring product delays and cost overruns that could damage the company’s reputation and hurt its share price.”

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7. Ernst & Young LLP, Unlocking the strategic value of Internal Audit: three steps to transformation (Ernst & Young Global Limited, 2010), 8.

8. Ibid.
“Internal audit’s job is to provoke [thinking about] the unthinkable and ensure we have a plan.”

- **International operations and corruption risks.** As audit committee chairs know all too well, the regulatory and compliance risks associated with corruption have become significant in recent years. For example, in the past year, the U.S. Department of Justice (DOJ) “has imposed the most criminal penalties in Foreign Corrupt Practice Act-related (FCPA) cases in any single 12-month period, ever. That’s more than $1 billion worth of penalties.” One audit committee chair said that in response, internal audit staff are “enhancing their focus on certain aspects of their work that deal with FCPA.” In addition, last year the UK Government passed its Bribery Act, which applies to UK companies and companies with foreign operations in the UK, even if offenses take place in a third country and are unrelated to UK operations, and to UK citizens regardless of where offenses take place. While the UK Government delayed implementation of the law in January 2011, companies are not relaxing their vigilance regarding the risk that it poses.10

- **Business continuity and crisis management.** With its increasing role in all types of risk, internal audit is naturally involved in preparing for crises and managing in their aftermath. One internal audit executive said, “Internal audit’s job is to provoke [thinking about] the unthinkable and ensure we have a plan. If you have a piece of paper, that doesn’t mean you have a plan.” Another internal auditor said, “Every audit program should have a business continuity risk process. For example, look at payroll and accounts payable: if the system goes down, what do we do? Also, we have manufacturing in third-world countries. If something happens, what do we do? Do you have a backup plan for your IT systems? Can you recover in an hour?” Some internal auditors are working with the audit committee to ensure there are crisis management plans: “We just talked about crisis communications at the last couple of audit committee meetings. What do you do when bad things happen to your products?”

- **Contractor due diligence.** An audit committee chair explained, “We’ve started a program where internal audit does a very detailed audit of outside contractors. It’s amazing what they’ve found. They have actually become a profit center. In one case, we found an employee was getting kickbacks. [In] another, we found there were ghost people on the payroll ... because of this we’ve totally revamped the way we have written our contracts with these contractors.”

A greater advisory role in governance matters

Internal audit departments are getting more involved in advising companies and their boards on corporate governance processes and procedures, including ethics and strategic reviews. One internal audit advisor said, “Internal audit should help ensure good governance. If internal audit can’t give assurance on effective governance, I don’t know who can.” Internal audit can help companies enhance their governance in several ways:

- **Through involvement in corporate governance processes.** The IIA survey mentioned earlier predicted more involvement of internal auditors in corporate governance matters in the next five years. One internal audit advisor said internal audit departments “could look at the structure and the communication to the board and compare it to NYSE listing requirements, laws and committee charters.” Internal audit departments could “maintain a schedule that keeps up with all of the requirements and outlines all of the requirements of the board.”

- **Through examination of management decision-making processes.** An internal audit executive said, “In the 2011 audit plan, we have a number of audits that are going to look at the strategic processes that have been employed by the company. We don’t give an opinion of strategy, but the strategic process is an important process, like many other processes in the company. We see if that process is adequately governed.”

- **By advising on audit committee effectiveness.** Participants described several areas in which internal audit is helping the audit committee become more effective:

  - **Educating the audit committee.** An internal audit executive said, “The first thing we need to know is what keeps the audit committee up at night, and how can we help them.” One advisor said, “Internal audit functions are becoming more leading edge, and taking on communication and education is a vital part of what they do ... audit committee chairs change, and internal audit has a responsibility in educating the audit committee on what’s important.”

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11. Institute of Internal Auditors, “Initial Findings from Global Study Reveal New Direction for Internal Audit.”
• *Helping shape audit committee charters and agendas.* One internal audit executive explained his role in preparing and finalizing audit committee agendas with the audit committee chair: "I coordinate with all the interested parties here at the company: the controller, CFO, external auditors and corporate secretary. I gather all the information they want to talk about for the entire year. I have a spreadsheet that I have to keep track of. I gather agenda items, distribute it and get everyone comfortable. Then I send it to the audit committee chair, who may want to change a few things. It is a real collaborative process."

• *Guiding executives on how to present to the audit committee.* Given that internal audit executives attend audit committee meetings and work closely with audit committee chairs, participants agreed that internal auditors can be excellent coaches for management colleagues on how to make more effective presentations to the audit committee. One internal audit executive helps oversee dry runs of colleagues’ presentations and advises, "You need to know who your audience is. These are people who are running companies — they are not interested in basic definitions. The board hates it when people are not prepared. My advice is (1) be prepared; (2) know the facts; and (3) have topics that the management team is sure [the audit committee is] talking about."

Taken together, this broader set of responsibilities provides internal audit with greater opportunities to help root out and mitigate key risks, make significant process improvements and cut costs — in other words, truly add value to the company.

**Questions for audit committees**

- How has the scope of internal audit changed at the company? In which specific business areas does internal audit play a more prominent role?
- What is the most appropriate role for internal audit in ERM at the company? Why?
- How could internal audit enhance governance and strategic processes at the company?
- How could internal audit help improve the audit committee’s effectiveness?
Internal audit needs to enhance its effectiveness

Internal audit departments are changing their approaches, in some cases significantly, to meet their evolving mandates. As one internal audit advisor put it, “Stakeholder expectations are not going to diminish. You have to get better and faster.”

Managing their talent pool more actively

Participants in this research said the broader internal audit mandate requires a mature, agile, flexible internal audit department that can respond quickly to new requests: “It’s a step change in terms of what’s required in internal audit. We don’t have entry-level people. Our business is too complex, and we put these people out in front of our business.” Participants noted several ways they are enhancing the quality of their departments:

- **Optimizing the team structure.** One internal audit executive shared how the company made its department’s structure more flexible: “From a structured point of view, [our internal audit department] was a very pointy pyramid with all kinds of levels. This was creating an awful lot of inflexibility, because each level had inflexibility – only the supervisors could lead an audit. In agreement with the audit committee, we flattened the structure, got rid of the levels and now the lowest common denominator is anyone can lead an audit.”

- **Recruiting personnel from a broad array of backgrounds.** One internal audit executive said, “The real power of internal audit is at any point in time to bring the right mix of skills and competencies ... to step back and exercise skepticism on the processes and procedures of the company. You need to put together a team of people that understands that.” Internal audit departments are recruiting talent from a wider variety of backgrounds. One executive explained, “We now look for more variety in our people [in internal audit], including engineers, scientists, management consultants and people with change management experience.” In addition, internal audit departments are increasingly hiring auditors with a greater level of academic experience. According to the 2010 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.”  

Rotating talent in and out of internal audit. One advisor said, “There is a trend toward a robust rotation plan that is [two-way]. Internal audit is becoming a pipeline for talent ... and talent is being attracted to the function from [other parts of] the company. Some internal audit functions, as part of their regular reporting package to the audit committee, are tracking executive career paths to chart (and in some cases, ensure) a ‘tour of duty’ in internal audit as part of their internal resume.” Participants said that internal audit acts as a springboard, providing employees with an enhanced understanding of business areas. Two approaches were identified:

1. Implementing guest auditor programs. Participants said some leading internal audit departments are leveraging the expertise of employees in the business units for specific audits within a finite time frame. Guest auditors can enhance the effectiveness of an audit by leveraging their institutional knowledge. Employees who join internal audit for these guest auditor rotations learn specific auditing skills and become more familiar with audit processes. One participant said, “Guest auditing programs build knowledge sharing between internal audit and the business.”

2. Adopting an “up or out” model. One internal audit executive described an “up or out” model: “After three years, we expect people on the internal audit staff to go into the business, and if they don’t find anything, that is the way out [of the company].” This program raises the bar for the performance of the audit staff and provides the business with a consistent flow of talent from the internal audit department. One internal audit executive said, “Our trend last year was 15 in and 15 out. This year they are all going into good businesses and positions.”

Improving the career proposition. Participants said it can be a challenge to recruit people with broader business backgrounds into the internal audit department: “Recruiting is not easy. We’ve gotten better at it, but it can still be a challenge.” One internal audit executive explained a pitch to potential candidates: “I always tell people, ‘Every audit is a job interview. Internal audit is not a tenured job. You come and work for me, and I will make you a businessman.’” An audit executive said, “You can learn so much about the company working in internal audit. I remember when I was at a different company, I knew more about the sales process than the sales force. I had to explain their processes to them.”

Co-sourcing more effectively

To manage peak and trough capacity demands as well as costs, many internal audit departments use co-sourcing. Of those responding to the Ernst & Young survey on internal audit, 77% considered co-sourcing of their internal audit function, whether as a short- or long-term solution, to be a viable business option. Internal audit departments use co-sourcing for the following reasons:

- Fill skill gaps. One audit executive said, “You can selectively co-source to get the experience you need ... it’s evolving pretty quickly, and it’s hard to bring people on that quickly.” Another participant said they look to co-source to meet specific expertise requirements: “The future of technology is a big one for us, so we’ve been beefing up with resources in technology. If we don’t have enough in-house, that’s an area we would outsource.”

- Provide flexibility. One participant explained, “One reason I did more co-sourcing 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.” Another internal audit executive said, “I wanted the ability to have the people at the right place, with the right skills, at the right time.”

- Manage costs. Several participants said co-sourcing helps manage the costs more dynamically, without having headcount on the payroll. An audit committee chair said, “We are trying to figure out how [to get the most expertise]. We want more expertise in a higher-quality, lower-cost way.”

Using new technologies

Internal audit departments are always interested in leveraging new technologies to help them “cover more ground in a more timely fashion.” Participants appreciated the power of technology to help streamline processes and create cost efficiencies throughout the organization: “The principal areas of optimization are in leveraging the technology to support the analytical part of our job. It’s about being able to digest a huge amount of information and making sense of that in an efficient manner. We either use the company’s systems or acquire new systems.”

“There is a trend toward a robust rotation plan that is [two-way]. Internal audit is becoming a pipeline for talent ... and talent is being attracted to the function from the company.”

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13. Ernst & Young LLP. Unlocking the strategic value of Internal Audit: three steps to transformation (Ernst & Young Global Limited, 2010), 9.
Participants said there are a host of programs that help internal audit departments identify more risks faster. One audit committee chair said, “We use a software package that provides audit analytics and continuous monitoring services. Internal audit applies it to all types of activities in order to continuously monitor unusual transactions that might flow through accounts. It is helpful from a risk standpoint as well, so you can apply those techniques to understand if the risk you identified in a certain area … might be heightened.” However, one internal advisor cautioned, “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.”

Building better relationships with colleagues and the external auditors

Internal auditors interviewed for this research reported that building better relationships with executives in the organization is critical. “The audit shop cannot be successful unless they have strong relationships with key executives and ask, ‘Are there things we need to do differently? What issues have come up? Is there anything we need to investigate or audit?’ Then I go and check on the things they asked about and report back to them.”

• Personal one-on-one meetings. “I meet with all of our key executives and ask, ‘Are there things we need to do differently? What issues have come up? Is there anything we need to investigate or audit?’ Then I go and check on the things they asked about and report back to them.”

• Quarterly meetings with targeted individuals. “We formalized a process where we have quarterly meetings with a number of targeted individuals. We have our staff have meetings with people we really want to get to know.”

• Collaborate on the audit plan. “We have an annual process where we go through the audit plan with business line leaders and executives who are owners of processes and build an audit plan. It is really a collaborative process and helps build relationships.”

• Develop a business calendar and have a seat at the table. “Internal audit functions are developing business calendars to create a rhythm with the business. When internal audit is present at strategy and budget meetings, for example, they have a strong sense for where the business is trying to go and how internal audit can help them get there faster through sound risk management practices.”

• With the external auditors. All participants advocated having internal audit build strong relationships with the external auditors. One internal audit advisor said, “There must be regular and informal communication between internal auditors and external auditors. The company will suffer if there is a lot of mystery between what the external audit and internal audit is looking at.” One internal audit executive described improved communication with the external auditors: “I have an excellent relationship with the external auditors. Prior to when I came here about a year ago, there was a tendency for the controller to meet more often with the external auditors. That’s changed. Now [internal audit has] monthly lunch meetings with the audit partners. The topics we discuss and the focus is often different. We’ll focus on IT controls, financial controls and business optimization.”

Several participants noted that none of these issues are new — internal audit has always sought to improve and become stronger. However, the higher expectations on internal audit to add more value, coupled with a much broader mandate, necessitate even greater efforts in that direction.

Questions for audit committees

• How are internal audit departments changing their structure and (or) personnel to adapt to their expanding mandate?

• What skills and experience make for a strong internal audit department? How do companies attract this new talent?

• What new technologies are best for enhancing internal audit’s effectiveness?

• Does internal audit have strong relationships with key people in the organization? With the external auditors?
Internal audit's evolving role: a proactive catalyst of business improvement
Audit committees need to guide and support internal audit more actively

All participants agreed the audit committee can offer valuable support to internal audit and enhance internal audit’s position in the company. Research participants emphasized this support is increasingly necessary as internal audit takes on new roles in a variety of different business areas. One internal audit executive said, “Our relationship with the audit committee has always been extremely important, but it’s time to re-emphasize it.”

Clarify the role of internal audit

One internal audit executive summarized a sentiment heard from many: “My world changes given the nature of the expertise of people on the audit committee and on the personality of the audit committee chair.” Internal audit executives were unanimous in their plea for more clarity in their mandate from audit committee chairs and management. For example, what are the most critical aspects of their role? What is the appropriate balance between risk and control work, and between process improvement and advisory work? These issues directly affect the audit plan and resource and skill needs inside internal audit.

Visibly support internal audit

Internal auditors look to the audit committee for support within the organization. One said, “I am paid to exercise healthy skepticism, and that’s where the audit committee can help. We are paid to press the button [if we identify major issues], but it hurts [our colleagues] sometimes. The audit committee can give us … reassurance.” One internal advisor said, “The audit committee needs to hold management responsible – openly – for implementing the recommendations that internal audit makes or explaining why they did not make those recommendations.”

Participants said the audit committee can raise the profile of the internal audit department. One internal auditor explained, “The audit committee chair can break a logjam in the company. The chair will encourage internal audit to identify issues, and that will strengthen internal controls. The audit committee chair role provides more authority to internal audit. Internal audit has a bigger seat at the table when the audit committee chair is supportive.” Audit committee chairs all agree that “internal audit is the audit committee’s eyes and ears in the organization.” Therefore, it is important that audit committee chairs champion internal audit’s role in discussions with business lines. One audit committee chair said, “We try not to position [internal audit] as the FBI, secret service or cops – they are here to help you more effectively run your business units.”

Ensure internal audit remains independent

As internal audit gets more involved in key emerging risks, participants stressed that companies have to be “careful” not to let internal audit advise on processes they audit, or vice versa. An audit committee chair said, “Internal audit should not do anything … that compromises their independence.” Participants said there are “safeguards” that companies can put in place to ensure this independence. One advisor said, “Internal audit is not making recommendations about risk coverage or controls; all they are really doing is trying to understand. They are looking at the communication and the different thresholds for risk that they’ve defined. What is the level of materiality, for example? The business has to decide what are the high, medium and low risks. All internal audit does is provide insight and a barometer about what else is going on in the business and external benchmarking.” One participant said, “The [head of internal audit] should be getting their marching orders from the audit committee chair. It helps if the chair is involved in annual performance and compensation reviews of the [head of internal audit].”

Ensure internal audit is staffed appropriately

Several audit committee chairs reported spending time getting to know the internal audit staff beneath the head of internal audit. This has the dual benefit of providing the audit committee with a view of internal audit’s bench strength while boosting the morale of the internal audit department. One audit committee chair said, “I get to know the number two and three – I insist on that. They need to present at the audit committee meeting so that there is some succession planning.” Another said, “The head of internal audit and his two or three [direct reports] come to the [audit committee meeting] to present. They get exposure to the board and they feel important. I also try to have dinner with the group the night before … if they’re going to some remote outpost, I will go with them to let the people in the field know how important I think they are.”
Evaluate internal audit’s value added

The IIA lists an external quality assessment, or peer review, as one of its requirements for compliance with the international standards for the professional practice of internal auditing. They encourage companies to conduct these assessments once every five years. Participants had differing opinions on the benefit of these peer reviews, however. One audit executive found them useful: “In our five-year peer reviews, we get another professional to come in with a pair of fresh eyes. It can be very helpful.” However, an audit committee chair said, “Frankly, I think there might be slight value in making sure you’ve achieved a minimal level of competence, but I don’t put a lot of stock in it at all. I think they’re looking backwards, and oftentimes their set of best practices is last year’s best practices. I would never take the peer review as the seal of approval.”

Participants described several other ways in which they measure the value internal audit brings to the organization.

- **Audit coverage.** Long-standing metrics examine how well the audit plan covers the audit universe over a one-, two- and three-year period and the degree to which the agreed annual audit plan is completed on time. More recently, some internal auditors have sought to develop metrics that measure the “percent of the audit plan that is directly linked to business objectives.”

- **Recommendations implemented.** One participant said the best way to measure internal audit’s value is to regularly measure internal audit recommendations: “New indicators of value include finding out what percentage of process improvement recommendations are implemented into the business.”

- **Surveys of those who are audited.** One internal audit executive explained, “We issue a survey to our [colleagues] after every audit. We ask, ‘How well did we know the business? Were we ethical? Confidential? Did we add value?’ There are about 20 questions that we pose that really help us understand how we did.” Leading internal audit groups track these ratings over time.

- **Management requests.** Several internal audit executives agreed with one who said, “I really think the best way to evaluate [internal audit] is to measure the requests you are getting from management. It is a great thing if the business is increasingly coming to [internal audit] to look at something, as opposed to [internal audit] going to management.”

In line with the transformation inside internal audit, the role of the audit committee is also changing. Post-SOX, audit committees focused on supporting the establishment or expansion of internal audit, as regulators and investors elevated its role inside the company, and on ensuring internal audit played a major role in the implementation of new internal controls over financial reporting. The audit committee also oversaw internal audit’s transition away from SOX 404 controls as these got embedded in the business. Now, the committee has a major role to play in guiding internal audit as the latter’s mandate expands. In particular, the audit committee can help ensure there is clarity across the organization about internal audit’s role and relevance to the company’s control and risk environment. The audit committee can also highlight internal audit’s value-adding activities.

**Questions for audit committees**

- How does the audit committee chair ensure that the audit committee, management and internal audit are all clear on internal audit’s mandate? How does the committee ensure that internal audit keeps the right balance between assurance responsibilities and operational improvement activities?

- How does the audit committee ensure that internal audit is staffed appropriately? Are robust succession plans in place at the senior levels of the department?

- How does the audit committee ensure that internal audit remains independent?

- What are the best mechanisms for assessing the value that internal audit brings to the company?
Conclusion

Audit executives and audit committee chairs interviewed for this research noted that the role of internal audit has experienced what one might call a “pendulum effect.” One audit executive said, “Internal audit seems to swing back and forth between compliance and operational improvements. Now we are really expanding to more parts of the organization as well as deepening our activity in areas where we've already been focused.” As internal audit’s scope expands, internal audit departments are building flexible, mature teams capable of proactively identifying key risks in a variety of business areas and of partnering with business to identify cost and process improvements. One audit committee chair observed, “Before, it was a ‘gotcha’ sort of attitude, and now it is more of an educational and partnering relationship to embed risk management and good corporate practices into the senior-management level of the organization.”

The transformation is not without challenges. It is stretching internal audit’s capabilities — both its human and its other resources — and it is creating additional tensions regarding its role, the manner in which it works and partners with the business and various stakeholders’ views of its success.

The audit committee’s role in overseeing internal audit is changing too. The audit committee must guide, support, counsel and evaluate internal audit more actively and must simultaneously make possible internal audit’s involvement with the business lines while also ensuring internal audit’s independence.

About Tapestry Networks
Tapestry Networks is a privately held professional services firm that brings leaders together to solve complex problems. Since 2002, networks convened by Tapestry Networks have tackled some of the most significant strategic challenges facing institutions and society, through public-private collaboration, including raising standards in corporate governance in the United States, Canada and Europe and developing strategies for a more sustainable healthcare environment in Europe. Tapestry Networks convenes seven audit committee networks sponsored by Ernst & Young that collectively consist of nearly 150 individuals, who chair more than 200 audit committees and sit on over 300 boards at some of the world’s most admired companies. For more information, please visit www.tapestrynetworks.com.

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SCORE no. CJ0174
Appendix: Research participants

For this report, Tapestry Networks drew upon approximately 40 interviews with audit committee chairs of Fortune 500 companies who participate in Ernst & Young's audit networks. For more on these networks, see www.tapestrynetworks.com/networks/net_audit.html.

In addition, Tapestry Networks interviewed a range of advisors, including:

- **James Brady**, Vice President, Group Internal Audit, AstraZeneca
- **Richard Chambers**, President and CEO, Institute of Internal Auditors
- **Stephen Frimpong**, Vice President, Internal Audit, Kimberly-Clark
- **Dominic Geller**, Head of Corporate Risk Management, Roche
- **Janice Harissis**, Vice President and Director, Internal Audit, Texas Instruments
- **Kiko Harvey**, Vice President, Corporate Audit and Enterprise Risk Management, Delta Air Lines
- **Frieda Ireland**, Head of Internal Audit, Telephone and Data Systems
- **Mike Jacka**, Senior Audit Manager, Farmers Insurance
- **Alan Johnson**, Chief Auditor, Unilever
- **Michael Marchesani**, Head of Group Audit, Zurich Financial Services
- **Yvonne Perlberg**, Vice President and General Auditor, Amgen
- **Rusty Russell**, Vice President, Internal Audit and Compliance, CSX Corporation
- **Steven Singer**, Americas Internal Audit Practice Leader, Ernst & Young LLP
- **Carolyn Sizemore**, Vice President and Controller, CSX Corporation
- **Dr. Natacha Theytaz**, Chief Audit and Advisory Executive, Roche
- **Dominique Vincenti**, Vice President of Internal Audit and Financial Controls, Nordstrom
- **Jacquie Wagner**, CIA Consultant, Risk Advisory Services, Ernst & Young LLP
- **Cathy Wilson**, Director, Internal Audit, RF Micro Devices
- **Charlie Wright**, Vice President, Internal Audit, Devon Energy
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SCORE no. CJ0174

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