

PricewaterhouseCoopers 2006
State of the internal audit profession study:
Continuous auditing gains momentum*

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Overview

Continuous auditing solutions are being pursued by chief audit executives as a means to shorten audit cycle times and provide more timely risk and control assurance to key stakeholders.

To address stakeholder demands for faster and better assurance, internal auditors are seeking to accelerate the frequency of their internal audit cycles. This quest is prompting strong interest in continuous auditing and its subset, technology-enabled auditing, which together have the potential to shorten audit cycle times and provide more timely risk and control assurance. With technology-enabled continuous auditing, an internal audit group can improve assurance quality because of its ability to audit 100% of a transaction universe as opposed to just transaction samples. In addition, by expanding the scope and frequency of the audit process, technology-enabled auditing allows internal auditors to communicate more effectively with business units, senior management, and the audit committee.

To capture a current view of the internal audit profession, PricewaterhouseCoopers conducted its second state of the profession survey for the field of internal auditing. We identified a decided lack of uniformity in how internal audit groups approach the issue of quality. We learned that the percentage of internal audit resources being devoted to Sarbanes-Oxley compliance is definitely tapering off. We confirmed that a shortage of talent continues to plague internal audit functions. And we found that a high percentage of internal audit departments include overall ratings in their audit reports.

Key indicators:

1. Eighty-one percent of 392 companies responding to questions about continuous auditing reported that they either had a continuous auditing or monitoring process in place or were planning to develop one.
2. From 2005 to 2006, the percentage of survey respondents saying they have some form of continuous auditing or monitoring process within their internal audit functions increased from 35% to 50%—a significant gain.
3. Fifty-six percent of our respondents said their continuous auditing processes include both manual and automated elements, 41% indicated their processes are entirely manual, and 3% reported having fully automated processes.
4. The most common continuous auditing “cycle” is quarterly, with 57% of our respondents falling into this category. Another 34% focus on monthly monitoring activities, while only 9% focus on daily applications of their continuous auditing processes.
5. Only 52% of our respondents reported having a formal quality assurance and improvement program in place. Only 49% said they either had completed an external quality assurance review or were planning to complete one prior to December 31, 2006.
6. The percentage of respondents devoting 100% of their internal audit resources to Sarbanes-Oxley compliance decreased from 23% in Year One to a projected 1% for Year Three. Only 33% of our respondents expect to devote 50% or more of their internal audit resources to Year Three compliance with Section 404.
7. More than half of our respondents indicated that Sarbanes-Oxley had led to an increase in their internal audit resources, with 35% reporting increases of 25% or more since the act’s requirements took effect. At the same time, 32% of our respondents in 2006—the same percentage as in 2005—reported actively recruiting for auditor positions that had been vacant for more than six months.
8. Seventy-nine percent of our respondents routinely include an overall rating or conclusion in their reports to reflect their audit results.

Trends

1. Continuous auditing gains momentum

The compressed time frames of today's business cycles are fueling increased demands from internal audit's key stakeholders for faster and better assurance. Senior executives and corporate directors are being asked to accept risks and make business decisions more quickly. To do so, they need more real-time or just-in-time assurance over risk management and related controls.

Yet despite being pressed for better and faster assurance, internal audit functions are being hampered in their response by the inherent limitations of traditional internal audit cycles, which are characterized by three time-consuming factors: annual risk assessments, complex internal audit engagement plans, and manual internal audit methodologies requiring extensive reporting.

These are familiar challenges for chief audit executives, who know that cycle acceleration is the key to providing faster and higher-quality real-time assurance to their primary stakeholders.

As our 2006 state of the internal audit profession survey reflects, the quest for greater audit efficiency and effectiveness is prompting many organizations to pursue the potential of continuous auditing and monitoring solutions. Of the 392¹ companies who responded to questions about continuous auditing in this year's survey, 81% reported that they either had a continuous auditing or monitoring process in place or were planning to develop one. Only 19% said they do not have a continuous auditing process in place and have no plans to develop one.

From 2005 to 2006, the percentage of survey respondents saying they have some form of continuous auditing or monitoring process within their internal audit functions increased from 35% to 50%—a significant trend that parallels our client experience. Of this 50% total who are active with continuous auditing, 13% said they have a process that is fully operational, and 37% said they have a process in place, although it is not yet fully developed. Another 31% of our respondents have plans to add a continuous auditing or monitoring capability.

¹ Of the 444 companies participating in the 2006 state of the internal audit profession survey, only 392 responded to questions about continuous auditing.

Both manual processes and technology figure prominently

Of note was the fact that manual activities and automation alike played significant roles in the continuous auditing activities of our 2006 survey respondents. Although only 3% claimed to have a fully automated continuous auditing process, 56% said their continuous auditing activities include both manual and automated elements. The remaining 41% said their continuous auditing processes were entirely manual in nature, a statistic that is sure to surprise members of the internal audit community who believe technology is an essential element of any continuous auditing activity.

In the past, continuous auditing was often viewed primarily as a tool to automate the testing of transactions. As far as it goes, this perception is accurate, for past efforts to incorporate continuous auditing into the audit approaches and methodologies of internal audit functions have, indeed, tended to focus on the use of tools to automate the detailed testing of transactions. Although the use of such tools is an important element of the continuous auditing concept, their ad hoc application to automate the audit process falls considerably short of the broader promise of continuous auditing to accelerate cycle times and improve the timeliness and quality of risk and control assurance.

Perceived benefits of continuous auditing

Technology can be an essential element in continuous auditing, serving as a key strategic enabler to enhance all aspects of the audit process, from strategic planning to the delivery of quality assurance. For example, the 41% of our 2006 survey respondents whose continuous auditing practices lack automated processes could likely gain even greater productivity from the selective application of technology.

Technology-enabled auditing, when deployed as part of a broader continuous auditing program, can make the audit process faster, cheaper, more efficient, and more effective. With a technology-enabled approach to continuous auditing, you can theoretically eliminate the need to rely on a linear model, where reports are only issued after an audit process and where audits are only conducted after an annual risk assessment. Instead, you can update all or portions of a risk assessment on a daily, monthly, or quarterly basis; automate periodic audit testing and improve audit cycle times; and compare and recalculate entire populations of data. By incorporating technology-enabled auditing into your continuous auditing approach, you can also improve assurance quality because of the newfound ability to rapidly audit 100% of a transaction universe as opposed to being restricted to data samples alone.

As these benefits strongly suggest, continuous auditing is far more than just another way to perform traditional internal audit activities more effectively and at a lower cost. By expanding the scope and frequency of the audit process, technology-enabled continuous auditing provides the means for internal audit to strengthen reporting to and communication with senior management and the audit committee, and to deliver more effective independent assurance to these key stakeholders.

By far the biggest benefit of technology-enabled continuous auditing, however, is how it can strengthen the ability of internal audit to communicate more effectively with business units. With technology-enabled auditing, auditors can provide more timely analysis of risk factors and control assessments and initiate more frequent discussions about emerging trends and the linkages between core financial and operational metrics.

Other survey highlights

Continuous auditing activities reflect breadth of internal audit cycle

When asked to describe the primary focus of their continuous auditing processes, more than half of our respondents selected either risk monitoring or audit testing of control effectiveness, and another fifth chose fraud detection. Specifically, 27% of our respondents focus on monitoring risk attributes to identify changes in risk profiles, 26% concentrate on audit tests to verify control effectiveness, and 20% focus on testing for unusual or fraudulent activities. In addition, 17% of our respondents focus on monitoring individual controls to identify control deficiencies, and another 10% focus their continuous auditing activities on monitoring key performance indicators to identify deteriorating business activities.

Ownership of the continuous auditing process

It is a leading practice in internal audit circles for those who own an audit in a particular business unit to also be responsible for continuous auditing activities in that unit. Therefore, it was good to note that 72% of our respondents with continuous auditing operations have settled on an operating model where process responsibility for continuous auditing and monitoring is embedded with those responsible for auditing a particular area. The owners of the auditing and continuous auditing processes are one and the same.

With respect to our other respondents active in continuous auditing, 22% place responsibility for these activities with a separate group within internal audit and 6% place this responsibility with the company's information technology (IT) group, a number we had expected to be higher. The relatively low number of IT groups having responsibility for continuous auditing suggests that technology-based auditing is by no means being treated as an "IT only" issue within the audit community, a factor that strengthens the role of internal audit in the process.

Daily, monthly, or quarterly schedules reflect audit priorities

The most common continuous auditing “cycle” is quarterly, with 57% of our respondents falling into this category. Another 34% focus on monthly monitoring activities while only 9% focus on daily applications of their continuous auditing processes. When the focus is on daily applications, organizations are typically conducting high-volume transaction activity in the search for fraud and other anomalies. When the focus of continuous auditing is monthly, auditors are typically looking for management accounting information, such as key performance indicators at a business-unit level that could indicate risk problems. And when the focus is quarterly, auditors are typically looking for entries (adjusting or closing) or transactions of unusual size that could affect quarter-end reports.

Purchased software dominates technology choices

Purchased software provides the basis for automation for nearly half (49%) of all respondents who said their continuous auditing processes include automated elements, while nearly a third (32%) of respondents rely upon custom-built and -programmed applications for their automation. Report writer/retrieval software, frequently deployed in conjunction with large enterprise resource planning programs, forms the basis for automation at 19% of this respondent group.

Principal challenges in establishing a continuous auditing program

The adoption of continuous auditing is a major undertaking, requiring internal audit to first gain audit committee and senior management support for its implementation, then determine where to start. Deciding which data points provide the best opportunity for analysis requires an assessment of both technical and operational considerations. Auditors also need to develop and maintain the technical competencies necessary to access, manipulate, and analyze the data contained in disparate information systems.

When asked to describe their principal challenges in establishing a continuous auditing program, 37% of our 380 respondents to this question identified defining activities to be audited, 20% said deploying technology, and 18% said obtaining internal support. For 13% of our respondents, the primary challenge was determining whether a business unit or internal audit should conduct the monitoring. Surprisingly, only 12% cited cost as their primary challenge.

Admittedly, continuous auditing is still considered an emerging phenomenon in some circles. But as our 2006 survey clearly reflects, continuous auditing methodologies are increasingly viewed by internal audit groups as a means to enhance their audit processes and results in order to address stakeholder needs and demands for faster and higher-quality real-time assurance.

With continuous auditing methodologies, you can:

- Make the audit process faster, cheaper, more efficient, and more effective
- Shorten audit cycle times to provide more timely risk and control assurance
- Achieve greater audit coverage without the need to expand your resource base
- Conduct audits on a daily, monthly, or quarterly basis
- Automate periodic audit testing and improve audit cycle times
- Audit 100% of data populations instead of just data samples
- Compare and recalculate entire populations of data
- Improve assurance quality as well as speed

2. Commitments to quality vary significantly

Given the fallout from corporate scandals and the combined push for quality from the Institute of Internal Auditors (IIA), major accounting firms, and corporate audit committees, one would expect to see a uniformly strong commitment to quality among internal audit functions. Surprisingly, this is not the case. As reflected by both our 2005 and 2006 survey reports of the internal audit profession, there is a definite lack of uniformity among internal audit functions with respect to how they demonstrate a commitment to quality.

In this year's survey, we asked internal audit executives if they had a formal quality assurance and improvement program in place that is consistent with the IIA *Standards*.¹ Only 52% of our 396 respondents said yes, while 48% said they lack a formal quality assurance and improvement program. What's more, only 49% of our respondents reported that their internal audit groups had undergone an external quality assurance review (QAR)² at the time surveyed, or were scheduled to complete a QAR prior to December 31, 2006.³ Fifty-one percent⁴ said they were not actively pursuing a QAR.

To probe the QAR issue more deeply, we asked those respondents who are not pursuing a QAR to explain why. Their reasons varied: 14% said their internal audit groups cannot meet the deadline on time; 30% said they follow the IIA *Standards* but are not planning to conform to the QAR standard; 15% said the cost of a QAR is prohibitive; and 10% said their internal audit groups do not adhere to the IIA *Standards* at all.

1 On January 1, 2002, the Institute of Internal Auditors issued revised standards for the practice of internal audit. These new guidelines, known as the *Standards*, updated the IIA's International Standards for the Professional Practice of Internal Auditing.

2 QARs are considered to be particularly important in management and audit circles, reflecting the enhanced role played by internal audit departments in the risk, control, and governance activities of many major corporations today. In addition to confirming compliance with the *Standards*, a well-designed external assessment will provide benchmarks and measurements that can be used to improve internal audit performance long after the external QAR report is issued.

3 Internal audit departments established after January 1, 2002, have until five years from the date they initiated operations to undergo an initial external quality assurance review.

4 This 51% figure included 30% of our Fortune 1000 participants—again, a surprising statistic.

When the IIA unveiled its new *Standards* for the practice of internal audit in 2002, it mandated that internal audit groups conforming to the *Standards* adopt formal quality assurance and improvement programs that include an external QAR at least once every five years.⁵ Although compliance with the IIA *Standards* is not generally mandated by statutes or regulations, its guidelines are often viewed as mandatory by internal audit executives, many of whom expected the vast majority of internal audit groups to react to the revised *Standards* by placing a greater emphasis on their quality assurance processes.

One explanation for the sharp divisions among internal auditors when it comes to demonstrating quality may be fallout from the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley, or “the act”). As our 2005 and 2006 survey reports have confirmed, compliance with Sarbanes-Oxley has been so demanding in recent years, and the role of internal audit in these compliance efforts has been so significant, that a number of audit committees and senior management groups may have placed strict adherence to recommended professional standards in the “nice to have” category rather than considering them an absolute necessity.

The consequences for internal audit functions failing to meet the QAR deadline remain to be seen. One motivating factor for internal audit functions rushing to meet the year-end 2006 deadline is that conformance to the IIA *Standards* will increase the likelihood of external auditors relying on their work as it relates to Sarbanes-Oxley requirements. Another potential motivating factor for fence-sitting internal audit groups is that their increasingly well-informed audit committees will note their lack of compliance with the QAR measure. However, as our surveys of the internal audit profession clearly indicate, a substantial number of internal audit functions appear willing to take their chances and take a pass on this newly implemented requirement.

A final point: Just because a company fails to complete a QAR by December 31, 2006, this action does not mean it will not complete one eventually. As mentioned above, one in seven of our survey respondents who are not pursuing a QAR at this time said it was due to time constraints.

5 PricewaterhouseCoopers, *How Quality Assurance Reviews Can Strengthen the Strategic Value of Internal Auditing* (November 2005).

3. Sarbanes-Oxley demands lessen, freeing resources for other priorities

The percentage of internal audit resources being dedicated to compliance with the Sarbanes-Oxley Act of 2002, while still high, may finally have turned the corner and be leveling off. Once freed of the demands of Sarbanes-Oxley, these resources are being redeployed to other priority areas, such as risk-based auditing, risk management, and continuous auditing.

Year-to-year comparisons of our survey results (see page 15) demonstrate just how dramatically the resource focus of internal audit is changing:

- In our 2005 survey of the internal audit profession, 23% of our respondents reported dedicating 100% of their internal audit resources to Sarbanes-Oxley during Year One compliance with the act. In 2006, only 1% of our survey participants projected that the act would require 100% of their internal audit resources during Year Three.
- In Year One of implementation, 71% of our reporting companies said they devoted 50% or more of their internal audit resources to compliance with Section 404¹ of the act, which requires companies to document, evaluate, test, and monitor their internal controls over financial reporting.² In Year Two, only 45% of our respondents were reportedly deploying 50% or more of their internal audit resources to Section 404 compliance. Projections for Year Three indicate that only 33% of our responding companies will be devoting 50% or more of their resources to Section 404 compliance.

¹ Section 404 of the Sarbanes-Oxley Act of 2002 requires management to develop and monitor procedures and controls for making their required assertion about the adequacy of internal controls over financial reporting. Section 404 also requires attestation of management's assertion by an external auditor. ("Internal Auditing's Role in Sections 302 and 404 of the U.S. Sarbanes-Oxley Act of 2002," © 2004, The Institute of Internal Auditors, 247 Maitland Avenue, Altamonte Springs, Florida, 32701-4201, USA.)

² In 2005, most Section 404 activities fell under the heading of project management, reflecting internal audit's demonstrated prowess in handling large and complicated projects. Areas of greatest focus included control review, management testing, process testing, walkthroughs, and documentation.

Resource allocations to compliance with Section 404 of Sarbanes-Oxley

	Year One actual (from 2005 survey)	Year Two actual (from 2006 survey)	Year Three projected (from 2006 survey)
100%	23%	5%	1%
75%–99%	27%	20%	12%
50%–74%	21%	20%	20%
25%–49%	15%	29%	35%
Less than 25%	14%	26%	32%

Assessing the impact of Sarbanes-Oxley on internal audit

In 2006, we asked survey respondents to assess how the strong focus on Sarbanes-Oxley compliance has affected internal audit coverage of operational and non-financial areas of audit. Of the 402 participants responding to this question, 23% said coverage of these areas had decreased dramatically (defined as 50% or more) and 22% said coverage had decreased somewhat. On the other hand, 43% said coverage had stayed about the same and 12% said coverage had actually increased.

In our 2006 survey of the profession, we also asked respondents to assess how their levels of internal audit resources have been affected by Sarbanes-Oxley. More than half reported that their resources had increased, with 15% reporting more than a 50% jump, 20% reporting an increase of between 25% and 50%, and 18% reporting an increase of less than 25%. Another 44% of respondents indicated that their internal audit resource levels had stayed about the same. Finally, 3% of our respondents reported a decrease in resource levels, for reasons unknown.

Reasons for shifts in resources

A number of reasons can be cited for the three-year downtrend in the percentage of internal audit resources being devoted to Sarbanes-Oxley compliance. These include:

- **Cost containment:** The high costs of Sarbanes-Oxley compliance efforts have prompted many companies to try to rein in these costs, leading to reductions in the levels of internal audit resources devoted to the act.
- **Getting back to basics:** There is a collective push among audit management and internal audit's key stakeholders to renew a sharp focus on basic auditing tasks.
- **Improved efficiency:** Process improvement and the application of technology have led to more efficient internal audit operations.
- **Reduced learning curve:** As companies adjusted to the act's requirements, they became more comfortable with its implementation and more proficient at optimizing their Sarbanes-Oxley compliance processes.
- **Reduced documentation efforts:** In Year One, companies had to make significant investments in documenting business processes and related controls over financial reporting. In Year Two and beyond, they were able to leverage these efforts and reduce their time commitments to documentation activities.
- **Clarified role definition:** During Year One of compliance with the act, 56% of our survey respondents reported having overall responsibility for Section 404 project management. As companies have become more adept at managing their Sarbanes-Oxley compliance activities, the primary role of internal audit in many organizations has shifted from direct management to monitoring.

Looking longer-term

As the results of our 2006 survey reflect, companies have made a number of significant adjustments to the demands of Sarbanes-Oxley after initially being overwhelmed by the act's requirements. Some organizations are placing primary responsibility for Sarbanes-Oxley compliance at the line level, while others are centralizing compliance with internal audit. Meanwhile, hundreds of organizations are exploring the merits of technology-enabled auditing as a way to increase audit efficiency.

Despite these adjustments, the compliance demands of Sarbanes-Oxley are still likely to dominate the focus, scope, and role of many companies' internal audit operations for years to come. In fact, internal audit groups reporting a decreased emphasis on operational and non-financial areas of audit because of the impact of Sarbanes-Oxley may find it difficult to provide the same level of assurance and service that was expected from them prior to enactment of this far-reaching legislation.

In our future annual surveys of the internal audit profession, we will continue to track the impact of Sarbanes-Oxley and similar legislation.

4. Internal audit faces a continuing shortage of qualified talent

Internal audit resources have expanded at many organizations since the enactment of Sarbanes-Oxley, as companies authorized staff expansions to cope with the act's mounting demands. However, many open internal audit positions remain unfilled because of a shortage of talent.

In our 2006 survey, more than half of our respondents indicated that Sarbanes-Oxley had led to an increase in their internal audit resources, with 35% reporting increases of 25% or more since the act's requirements took effect. At the same time, 32% of our respondents in 2006—the same percentage as in 2005—reported that they were actively recruiting for auditor positions that had been vacant for more than six months.

Changes in surveyed companies' internal audit resource levels since requirements of Sarbanes-Oxley took effect

Increased by more than 50%	15%
Increased by 25%–50%	20%
Increased by less than 25%	18%
Stayed about the same	44%
Decreased	3%

In today's operating environment, the demand for internal audit resources has increased much faster than internal audit capacity—a situation that raises serious concerns about the ability of internal audit groups to address higher-level risks facing their organizations.

As our surveys confirm, it is a major challenge to hire and keep qualified, capable internal audit staff. Legions of companies are looking for audit professionals with a sufficient breadth of capabilities to evaluate and test internal controls, audit complex areas, address enterprise-wide risk and governance issues, and provide insight into the adequacy of financial controls. Given such demands for specialized skill sets, it's no wonder there's a talent shortage.

Leveraging “capacity multipliers” to expand capacity

To address shortfalls in resources and to strengthen skill sets, capabilities, and productivity, an internal audit function can leverage “capacity multipliers” ranging from strategic co-sourcing solutions to technology-enabled auditing.

As our survey reports indicate, the use of third-party internal audit service providers to address resource needs and skill gaps continues to expand. This year, 71% of our respondents reported having engaged one or more internal audit service providers to assist in the delivery of internal audit services, an 8% increase from the 63% figure reported in our 2005 survey. The most common reasons for engaging third-party services are to acquire specialized skills, expand geographic coverage, provide flexibility in delivering an audit plan that is responsive to the dynamic needs of stakeholders, and augment staff for assistance with day-to-day internal audit responsibilities and compliance with Sarbanes-Oxley Section 404.

With the capacity-multiplier approach, you can also leverage functional or subject-matter expertise from within your company to augment your internal staff, set up a “guest auditor” system, or pursue a co-op or internship program with colleges or universities.

- **Leveraging functional or subject-matter expertise:** By tapping functional or subject-matter experts from within your company to supplement your internal audit staff, your engagement teams can gain additional insight into highly complex or technical areas and, in effect, leap the learning curve. Proven internal experts can also strengthen your credibility with executive and operating management. To ensure that you deploy such experts effectively, check their qualifications beforehand, take steps to ensure their objectivity, and deploy their expertise during each phase of the audit.
- **Employing temporary internal resources to augment your staff:** This strategy differs from the use of functional or subject-matter experts in terms of how you deploy such resources. With the temporary augmentation approach, your primary objective is to mitigate shortfalls in your resources. This technique is particularly effective when you are seeking to address temporary constraints in your staffing, assist with unique or special audit projects (such as Section 404 work), or assist with engagements in remote geographic locations. Taking measures to check qualifications, ensure objectivity, and provide adequate supervision are the keys to deploying this technique effectively.
- **Implementing a “guest auditor” or similar program:** A number of companies provide the opportunity for individuals working outside of internal audit in either line positions or staff capacities to serve as “guest auditors” with internal audit. With this approach, internal audit gains functional expertise and an in-depth understanding of various business units, while the guest auditors gain a better understanding of the company’s audit process and can serve as “goodwill ambassadors” for internal audit. At a number of leading companies, participation in guest auditor programs by non-career auditors is viewed as a key to career advancement.
- **Pursuing a co-op or internship program:** Co-op or internship programs, developed in conjunction with local colleges or universities, can also help augment resources as well as build talent for the future.

5. Most internal audit groups now include overall ratings or conclusions in audit reports

Most internal audit departments—including 85% of our Fortune 1000 respondents—now include overall ratings or conclusions in their audit reports. In our 2006 survey, 79% of the 377 organizations addressing this subject routinely include an overall rating or conclusion to reflect audit results.

Such ratings are strongly applauded by audit committees, which tell us they appreciate receiving knowledgeable, easy-to-grasp insights from internal audit about significant risk-management issues facing the organizations they oversee. At the same time, there is little consistency in either the basis for issuing such ratings today or in the approaches taken to developing such ratings, although the ratings process itself is now generally considered by many to be a best practice.

The increasing prevalence of audit ratings is being driven by a number of factors, including an increased focus on internal audit reports by audit committees, senior management, and external auditors; the desire by chief audit executives to synthesize the assessment of risks and controls; and pressure from regulators in certain heavily regulated industries.

With audit ratings, internal audit can determine the extent to which failure to identify risks or implement recommended controls contributes to business units falling short of their objectives. Audit report ratings also can serve as the basis for follow-up attention from internal audit or the audit committee and, in rare instances, can serve as the basis for adverse actions against members of operating or executive management.

Although the formats of audit ratings reports will vary, they are all constructed to convey a basic continuum of performance. A common approach is to rate the overall performance of the function, program, or activity subject to audit adjectivally: *strong, effective, adequate, requires attention, or weak*. Another approach might feature a “heat map” that assigns color designations derived from the number of action items stemming from an audit. For example, internal audit might assign:

- Red to an audit indicating weak controls and requiring multiple “red action items”
- Orange to an audit indicating the need for a moderate level of controls and requiring a business unit to address one or two “red action items”
- Yellow to an audit indicating the need for moderate controls and no “red action items,” but one or two less serious “yellow action items”
- Green to an audit indicating the presence of strong controls, where a business unit is consistently managing risks to an acceptable level

As one would expect, there are definite perceived advantages as well as disadvantages to including ratings with audit reports. On the plus side, audit ratings permit more rapid assessment of overall results by senior management and audit committees. They also help facilitate the design and implementation of monitoring systems by internal audit and various governance bodies. And, they can serve as a motivational tool to spur business units to strive for the top ratings possible.

On the downside, audit report ratings can undermine good auditor/client relationships by creating friction between internal audit and operating units. In such cases, operating unit managers may be reticent to share known control weaknesses with members of an audit team. Another disadvantage is the potential of audit ratings to increase audit cycle time by extending the reporting process.

Methodology

The 2006 state of the profession survey for internal auditing was conducted in the first quarter of 2006 and includes responses from 444 audit managers. Of the respondents:

- 80% are either chief audit executives or internal audit managers
- 59% are from companies with \$1 billion or more in revenue
- 79% are from internal audit departments with four or more staff

The survey had four purposes:

1. Capture a snapshot of the internal audit profession
2. Share insights and observations from PwC experts about the major issues, trends, and changes reshaping internal auditing today
3. Collect benchmarking data to help organizations compare and contrast their internal audit processes and procedures
4. Provide a baseline to measure ongoing changes in the profession

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