

Advisory Services
Internal Audit Services

Does your Internal Audit department meet expectations?

Survey of Internal Audit Trends in Hungary, 2007



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Executive summary

Introduction

- The survey was prepared by PricewaterhouseCoopers (PwC) and completed in July, August and September 2007 and is based on similar surveys conducted in CEE (Central and Eastern Europe).
- We organized the survey as a joint initiative with the Hungarian Institute of Internal Auditors (HIIA) and it was published on a password-protected website.
- Our objective was to provide an independent forum to report on key trends and emerging issues regarding many aspects of the Internal Audit (IA) function in various industry segments operating in Hungary.
- We would like to thank all of the respondents for their participation in this survey.

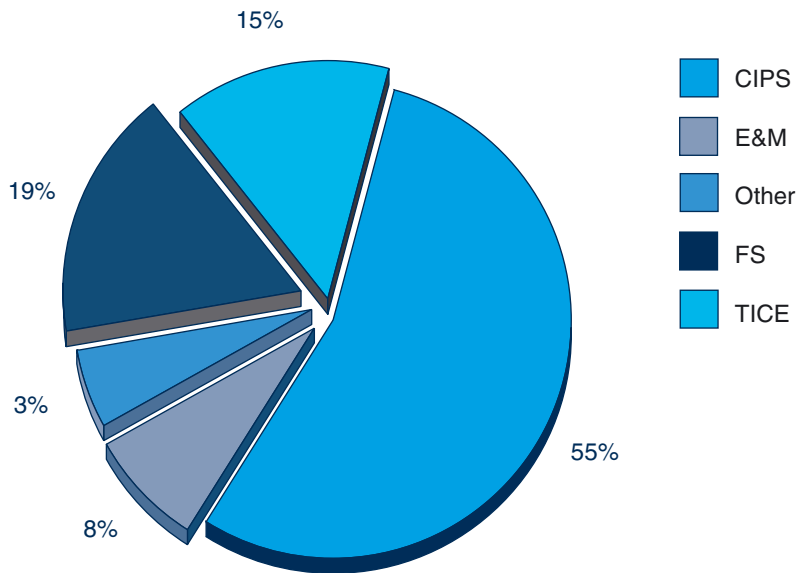
Response Base

- We mailed the survey to the Internal Auditors or CEOs/CFOs (when IA contact was not available) of companies listed in the 2005 edition of Figyelő Top 200 and additionally to some 50 companies throughout Hungary.
- None of the results that we received from any organization was or will be published individually.
- The overall response rate was 30%, with 75 responses received from companies that the surveys were sent to.
- A detailed analysis of the response rate and the response base by industry segment, number of employees and turnover category is presented on the following page.



Responses by industry segment

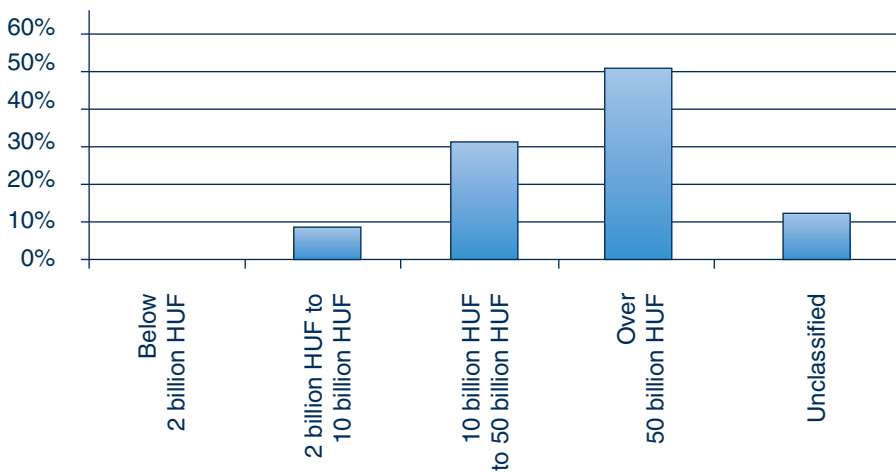
Percentage of total responses by industry segment



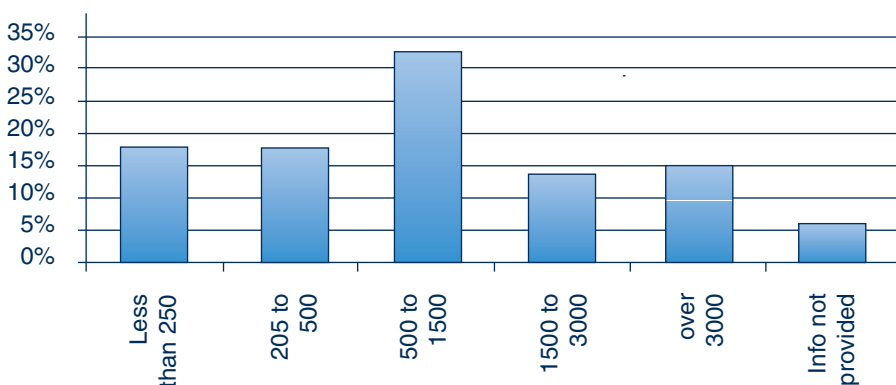
FS: Financial Services
 TICE: Technology, Information, Communications, Entertainment
 CIPS: Consumer & Industrial Products & Services
 E&M: Energy & Mining

Responses by turnover and number of employees

Percentage of total responses by turnover



Percentage of total responses by number of employees



Commentary

Types of organization participating in the survey:

- The majority of companies operate in the service or general manufacturing industry segments. A significant portion of the responses came from the Financial Services (FS) and telecommunications (TICE) sectors.
- Typical annual turnover is over 50 billion HUF.
- The majority of organizations (32%) have 500 to 1500 employees.

Key findings

Based on the review and analysis of the response data, the key findings are as follows:

Positioning of Internal Audit

- 79% of respondents have an Internal Audit function located in Hungary; the primary reason for not establishing such a function is that it is performed by Group Internal Auditors.
- One of three respondents believes that Internal Audit's added value is not fully appreciated by management and the function has insufficient support within the organization.
- The prevalent reporting line of Internal Audit is executive management (50%) and Supervisory Boards / Audit Committees (41%).
- Relatively few respondents (37%) have an Audit Committee in place.
- Internal Audit budgets are low; more than 90% of the organizations have budgets below 0.25% of net revenue.

Internal Audit Quality

- Full compliance with IIA standards is low; only 20% of respondents confirm full and an additional 23% confirm partial compliance.

- Only 67% of respondents have an Internal Audit charter in place.
- Two of ten respondents do not have a formal Internal Audit methodology.
- Only 48% of respondent organizations carry out at least an annual review of the quality of their Internal Audit function.
- 57% of respondents are not convinced that Internal Audit is using up-to-date tools and methods in its activities.
- The average time spent on training is between 5-10 days annually at 70% of the respondents.

Internal Audit Effectiveness

- The primary functional focus of Internal Audit reviews is compliance audits and internal key control assurance. The primary risk focus area is effective company operation and the development of an appropriate control environment.
- The primary areas of concern appear to be internal acceptance and support.
- 60% of respondents believe that their Internal Audit function is bringing high benefit at either low (39%) or high cost (21%). Only 9% of respondents believe that their Internal Audit function is bringing low benefit at a high cost.



PricewaterhouseCoopers points of view

Obstacles in the way of development

The survey revealed the following key issues that IA departments in Hungary face today:

Raising the profile of Internal Audit in the organization and demonstrating added-value to the business

The Survey reveals that in a number of organizations the Internal Audit function lacks full support within the organization (1 in 3 respondents believe there is insufficient support and that management does not appreciate the value). This weakness in positioning may be evidenced further by the low budgets (more than 90% have budgets below 0.25% of net revenue) and that fact that Audit Committees exist in only one-third of respondents. The overwhelming majority of respondents indicated “internal acceptance and support” as their most significant challenge. Going forward, Internal Audit functions will need to increasingly consider the value they bring to the business and how this value is communicated and leveraged within the organization.

Ensuring that working practices are up-to-date, representative of best practice, and compliant with IIA standards

One of the difficulties with raising the profile of an Internal Audit function within the organization may be a lack of consistency and best-practice. For example, 80% of respondents reported partial or no compliance with IIA standards. Furthermore, one-third of respondents do not have an Internal Audit charter in place, and more than

half are not convinced that they are using up-to-date tools and methods. Finally, 52% of respondents do not carry out a review of the quality of the Internal Audit function at least annually. Such a review can be key in identifying where gaps may exist in best-practice and where tools, processes, and structures can be improved to increase the value the function brings to the organization.

Way forward

Despite changes in the world of Internal Audit that we can see in Hungary, many organizations still seem to consider IA as a necessary overhead rather than an asset to initiate changes and create value. However, companies operating in a more developed market see it much more as a function that could and should deliver efficiency, effectiveness, and strategic value.

Certainly achieving these benefits requires investment first – investment in Internal Audit’s human resources, processes and infrastructure. To manage these three crucial pillars properly and efficiently, it is essential:

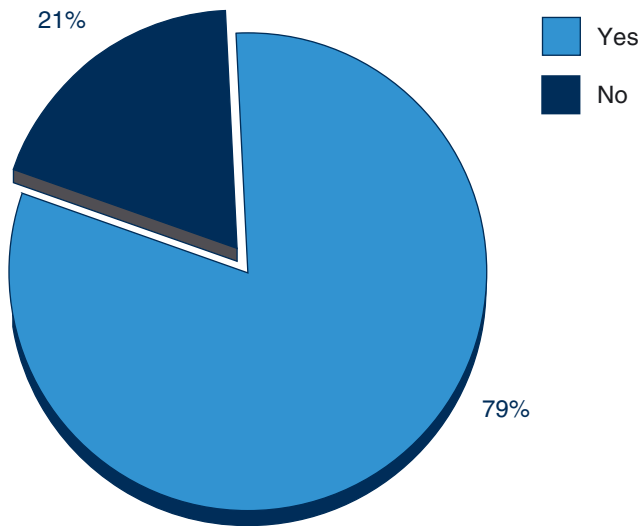
- to make every effort to **motivate** staff to obtain the CIA (Certified Internal Auditor) qualification and keep them up to date with new Internal Audit tools and methods;
- to implement **IIA standards** properly and assure staff’s full understanding in all respects;
- to carry out an **external Quality Assurance Review** to attract the attention of key stakeholders and enhance the strategic performance of Internal Audit.



Data Analysis

Organizations without an IA function

Percentage of organizations with an Internal Audit function out of the total number of responses:

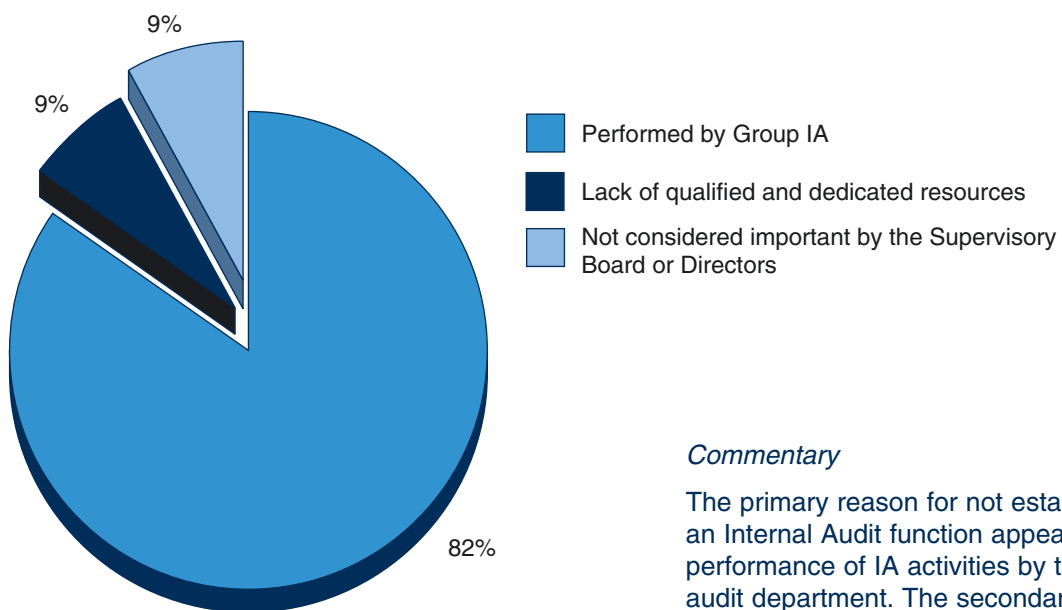


Commentary

79% of the organizations that responded to the survey have an Internal Audit function located in Hungary.

The lowest ratio with a locally-based IA function is in the CIPS sector (67%).

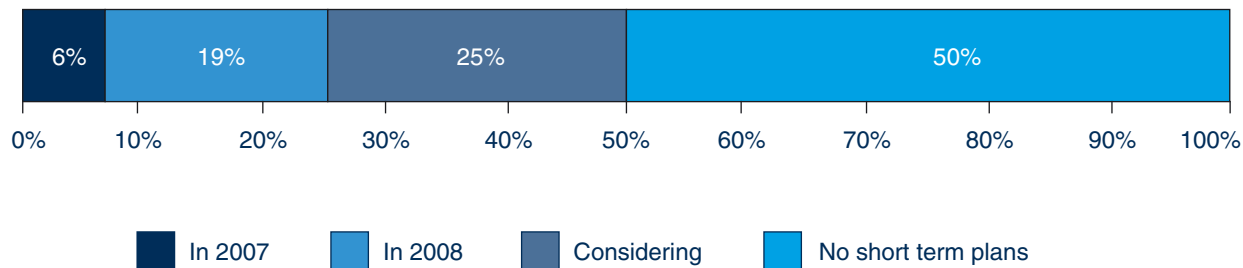
What is the main reason for the organization not having an IA function in Hungary?



Commentary

The primary reason for not establishing an Internal Audit function appears to be the performance of IA activities by the Group audit department. The secondary reason is lack of resources and a lack of interest by management.

Are there any future plans to establish a local Internal Audit function?



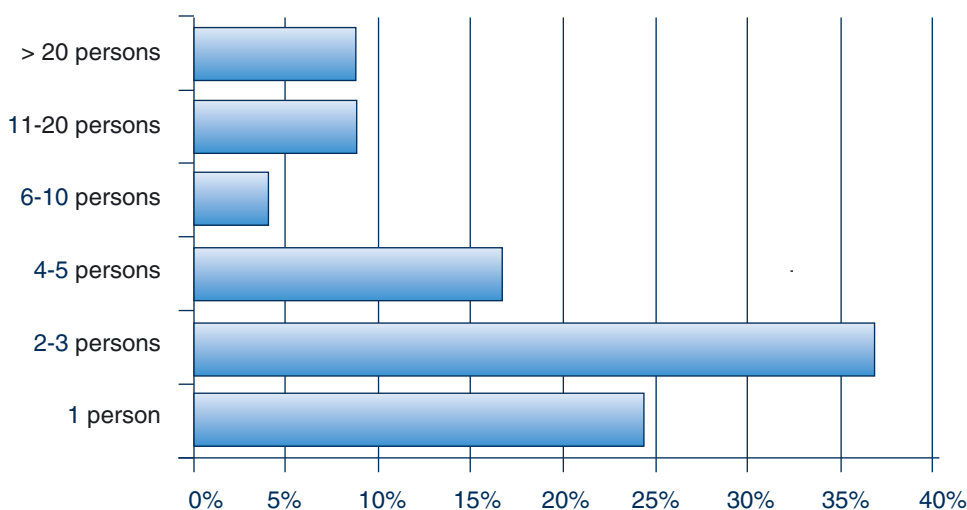
Commentary

50% of organizations without an Internal Audit function do NOT intend to establish an IA function for their local operations in the short term. 25% of respondents are considering establishing the function this year or next year and the remaining 25% are planning to do so.

IA organizations

Headcounts of Internal Audit groups

Percentage of responses by size of group

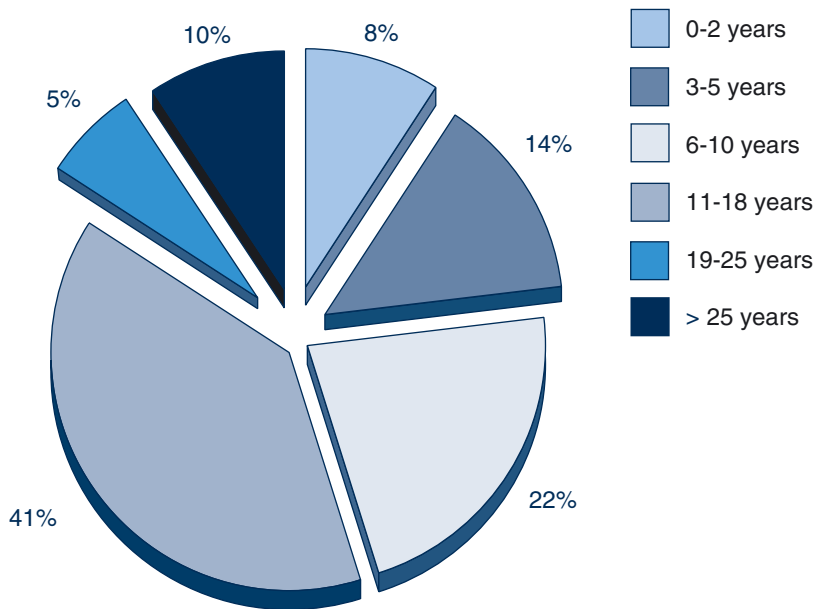


Commentary

Most of the IA groups are quite small. A quarter of the IA departments that responded are represented by a single auditor and another 54% have an IA group of between 2 and 5 persons. Groups with a headcount of over 10 are mainly TICE and FS companies.

Years of operation of the IA department

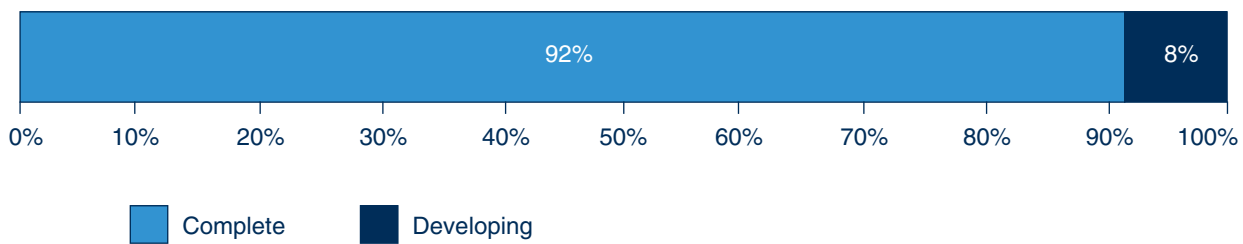
Percentage of responses by years of operation



Commentary

Most IA departments were established 11-18 years ago. The staff headcount tends to increase with the number years the IA has been operating.

Internal Audit organization completely structured or under development?

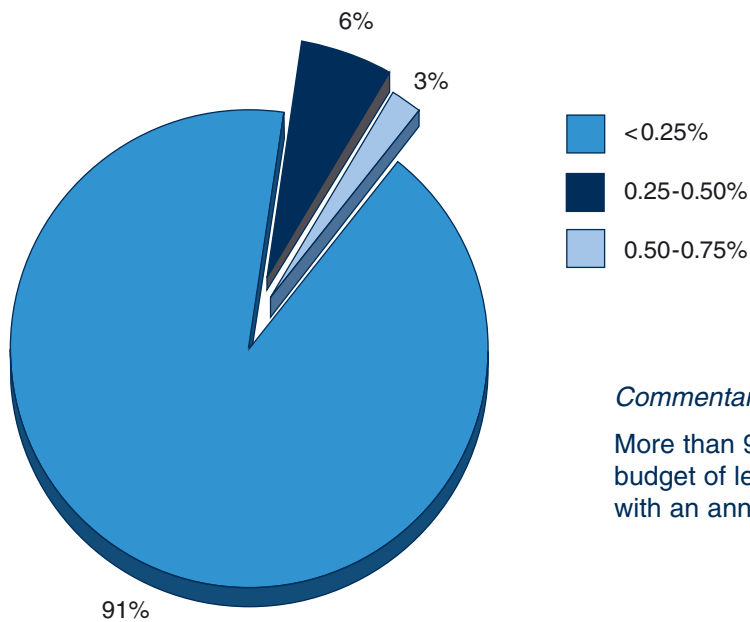


Commentary

Internal Audit organizational structure, responsibilities and activities are completely structured at 92% of respondent companies.

Budget available for Internal Audit

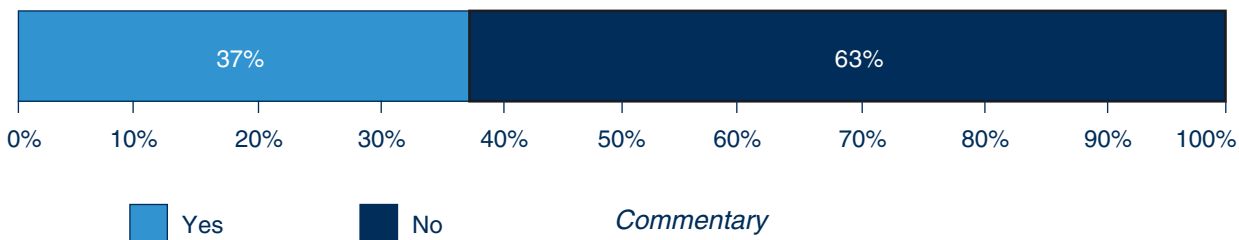
In percentages of net revenue



Commentary

More than 90% of the companies that answered the survey have a budget of less than 0.25% of net revenue. No answer was recorded with an annual budget of over 0.75%.

Is an Audit Committee in place?

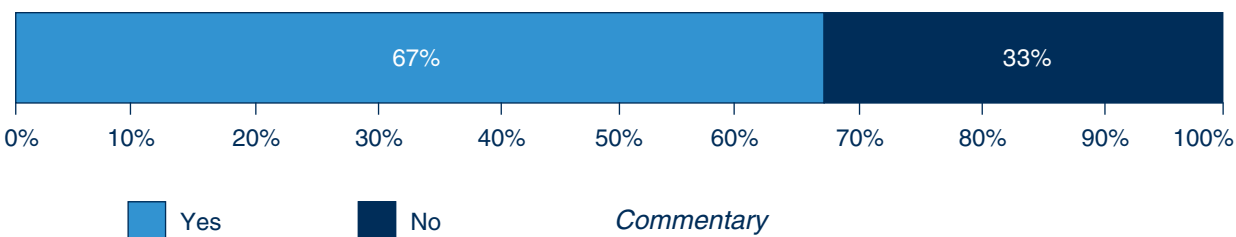


Commentary

Relatively few respondents have an Audit Committee in place.

IA operation

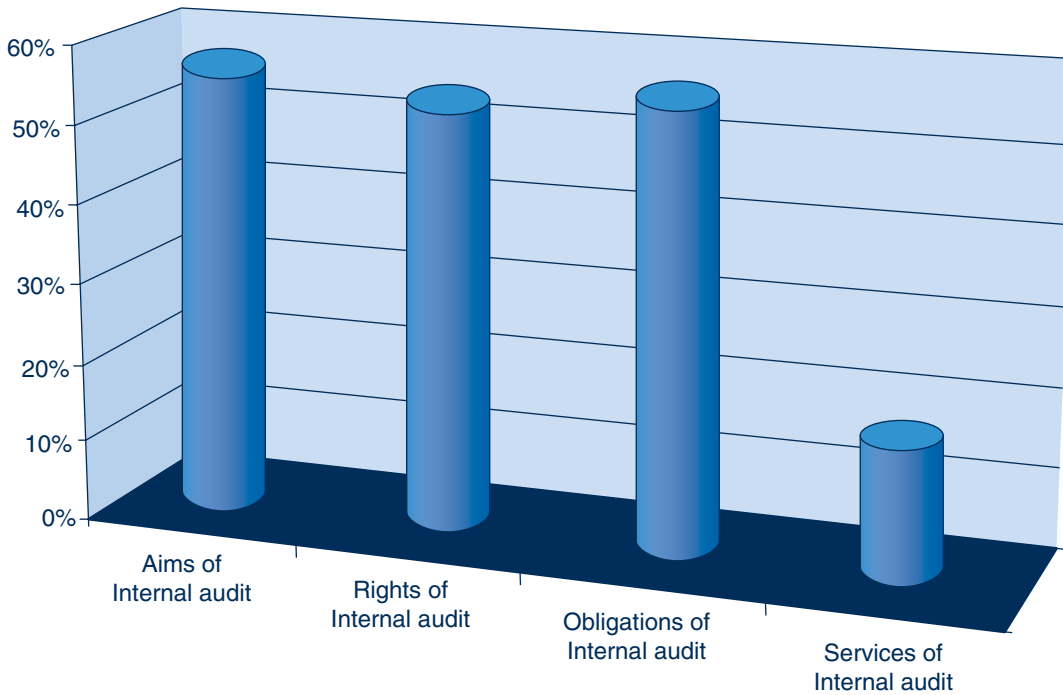
Does an Internal Audit charter exist at IA?



Commentary

Two thirds of respondents confirmed having a charter in place, which is a requirement of IIAS 1000.

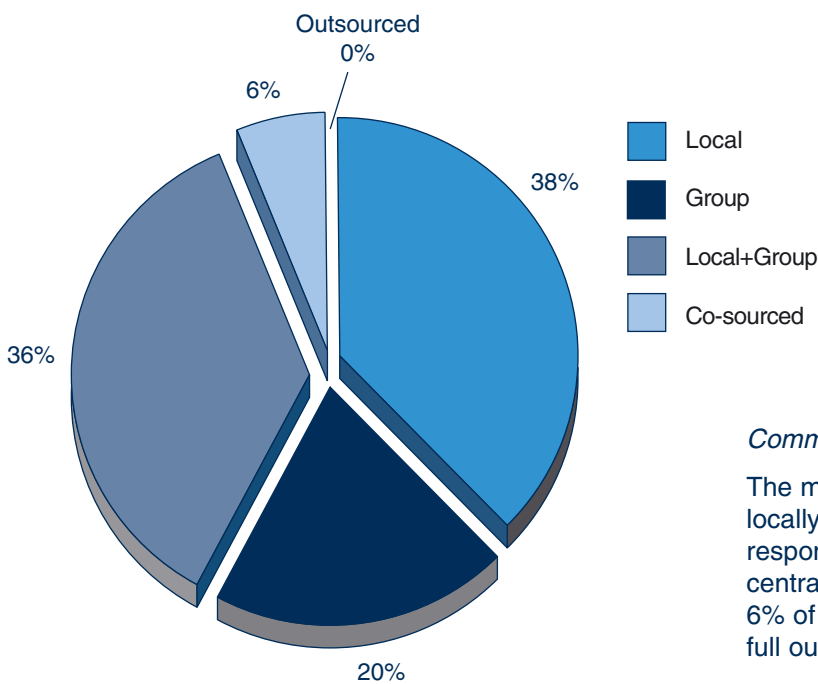
Are the following included in the Charter?



Commentary

Internal Audit department services are only included in the charter at 16% of the companies that responded, although IIAS 1000.A1 requires definitions of the services performed.

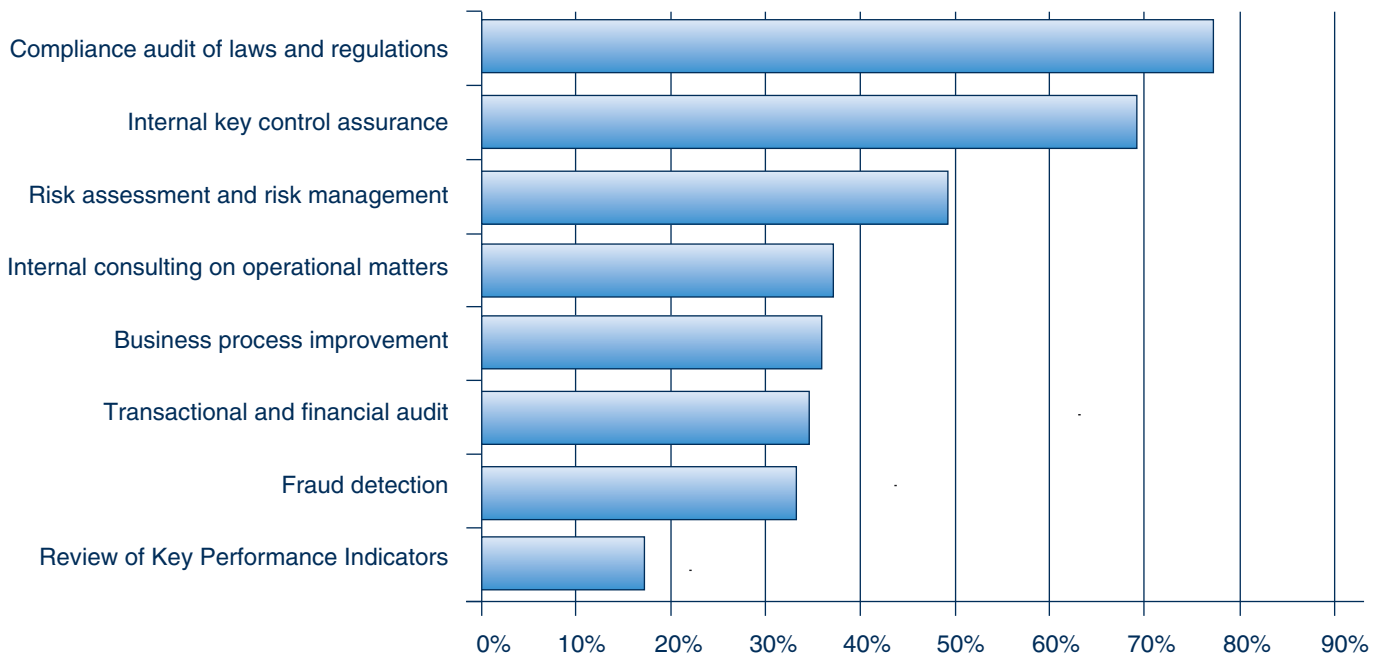
Who performs Internal Audit work for operations in Hungary?



Commentary

The majority of audit activities (74%) are completed locally or together with the Group auditors. 20% of the respondents confirm that the Internal Audit function is centralized. Specialist third-party providers are used by 6% of the organizations. None of the respondents use full outsourcing.

What is the functional focus of Internal Audit?

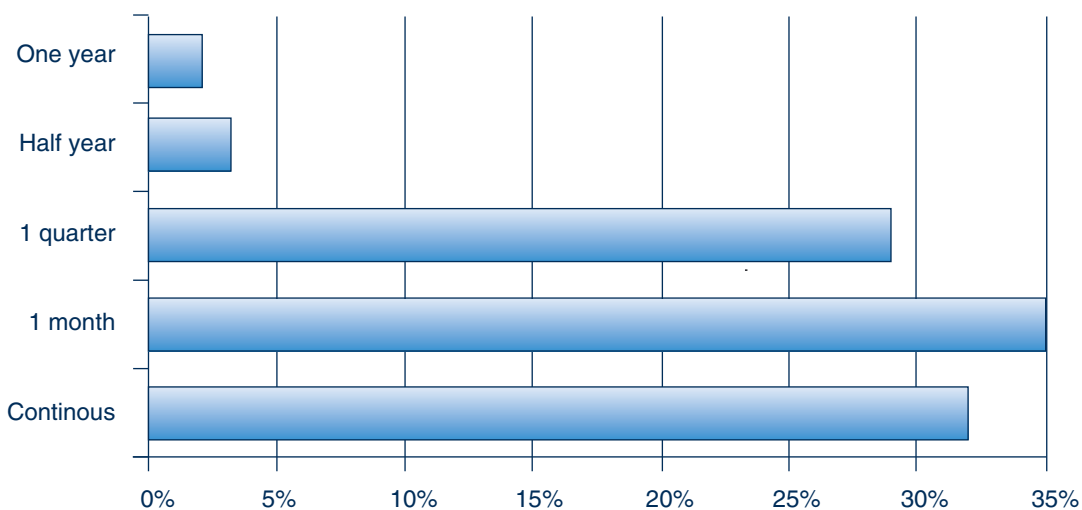


Commentary

Internal Audit departments are primarily focused on compliance and on internal controls. Risk assessment constitutes a main focus at around half of the respondents.

Length and timing of audits

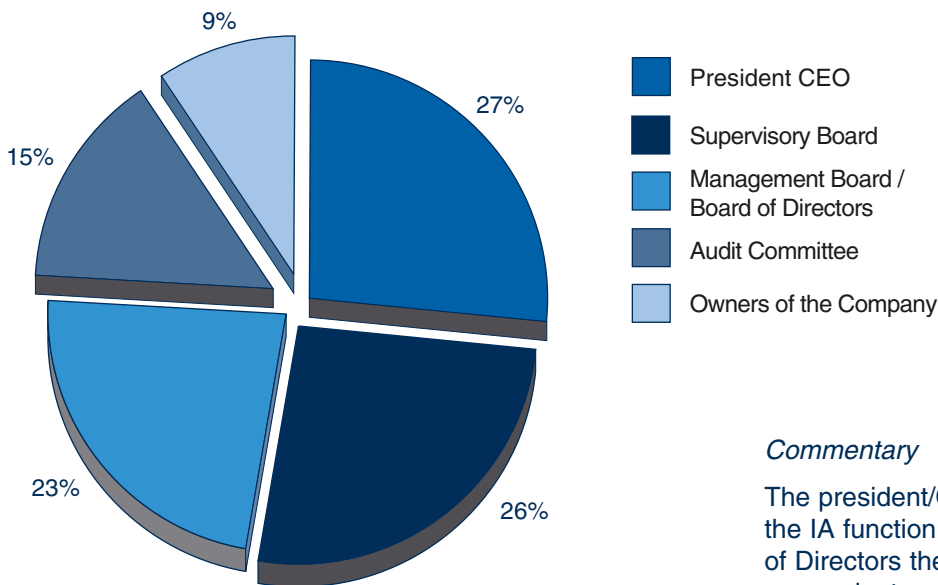
Percentage of responses



Commentary

One third of the respondents conduct continuous audits. Another third spends one month per audit. Companies with larger IA departments usually spend more time on an audit (over 10 persons, usually one quarter).

Who does Internal Audit report to?

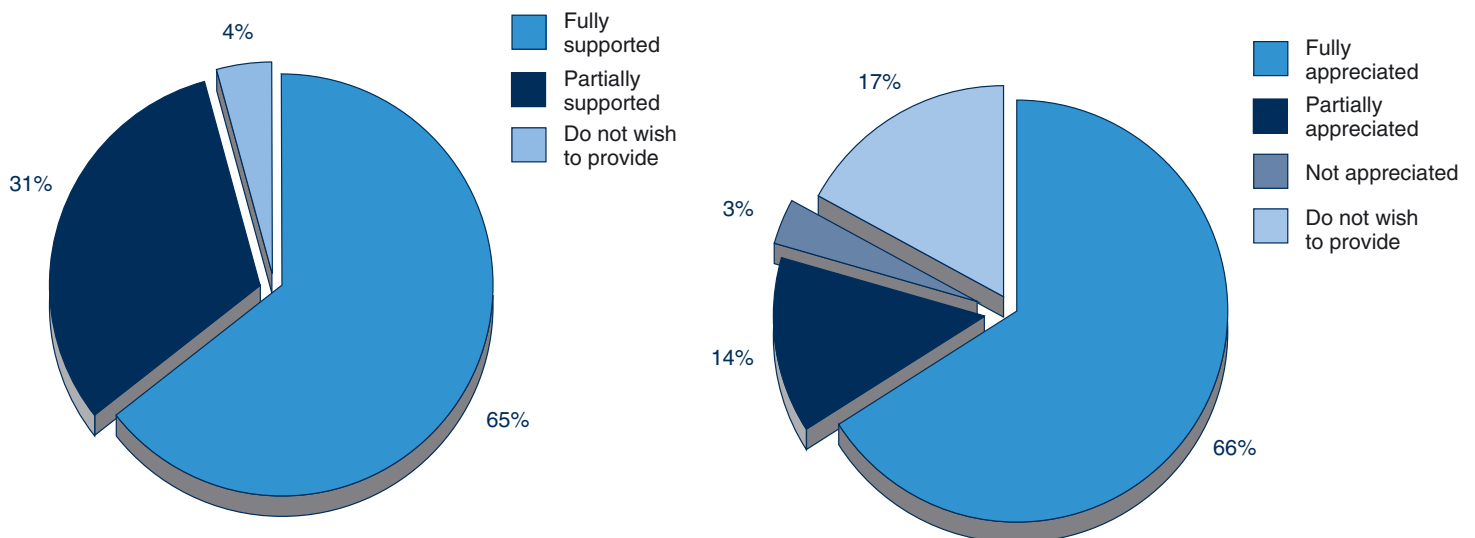


Commentary

The president/CEO is most likely to hold responsibility for the IA function. Together with the Management or Board of Directors they are in charge of IA at 50% of the respondents. Audit Committees and Supervisory Boards review IA work at 41% of the companies.

Expectations

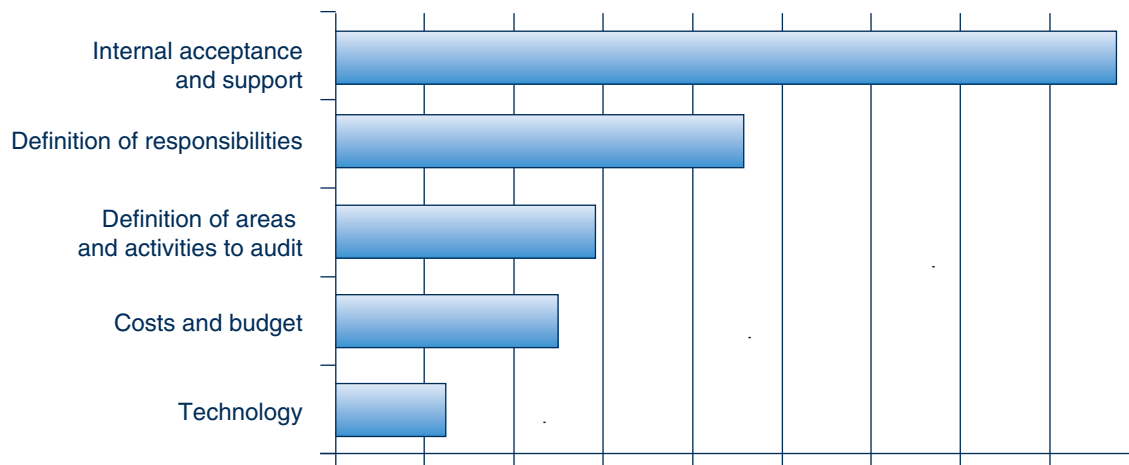
Is your Internal Audit function fully supported and its added value recognized by management?



Commentary

The IA function seems to be well positioned at around two thirds of the organizations. A relatively high 31% of respondents believe that their Internal Audit function does not have full support within their organization. Added value is not fully appreciated at 17% and an additional 17% did not wish to provide answer on this issue.

What is the Internal Audit department's most significant challenge?

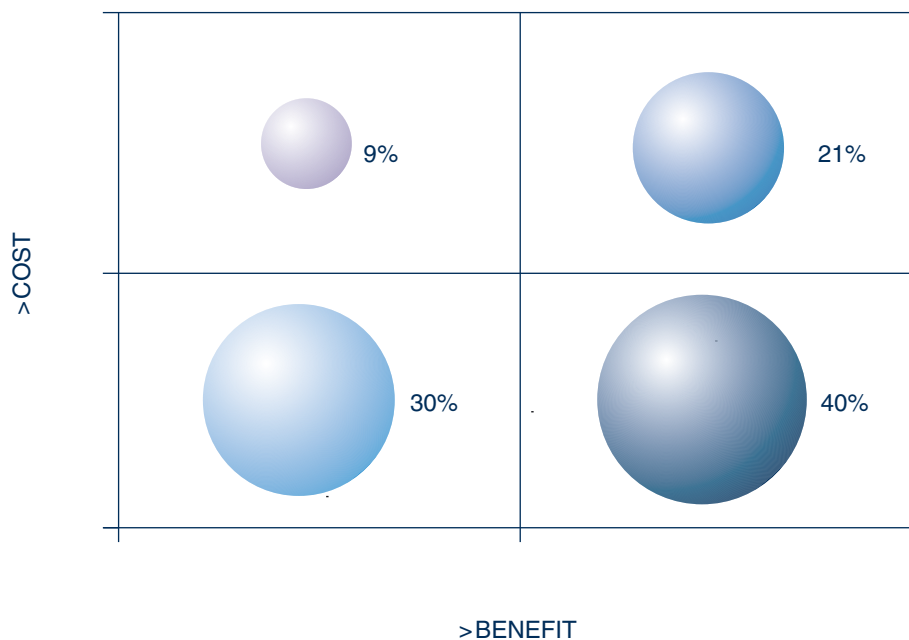


Commentary

The primary areas of concern are the definition responsibilities and internal acceptance. The latter was already projected in the previous topic and selected as key challenge by almost half of the respondents. Scope definition and budget are also frequent concerns at the respondent companies.

Perception of Internal Audit's added value compared to its cost

Benefit vs. Cost of Internal Audit function

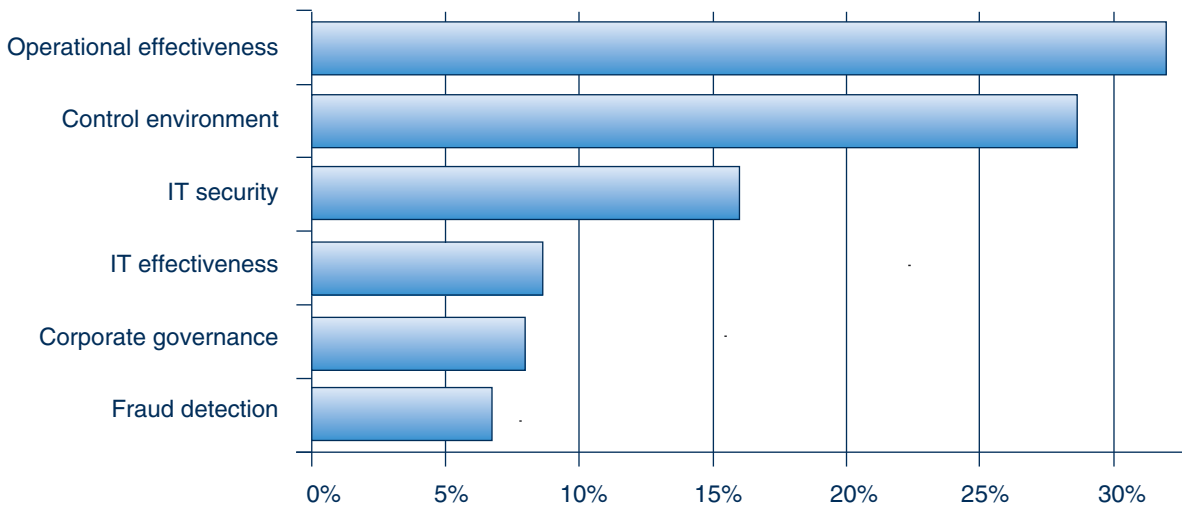


Commentary

61% of the organizations believe that their Internal Audit function adds high value to the organizations' work, which agrees with the previous topic where 66% of companies stated that management fully appreciates IA's added value.

Around half of the respondents believe that the benefit of the IA function matches its cost (i.e. either high benefit at high cost or low benefit at low cost).

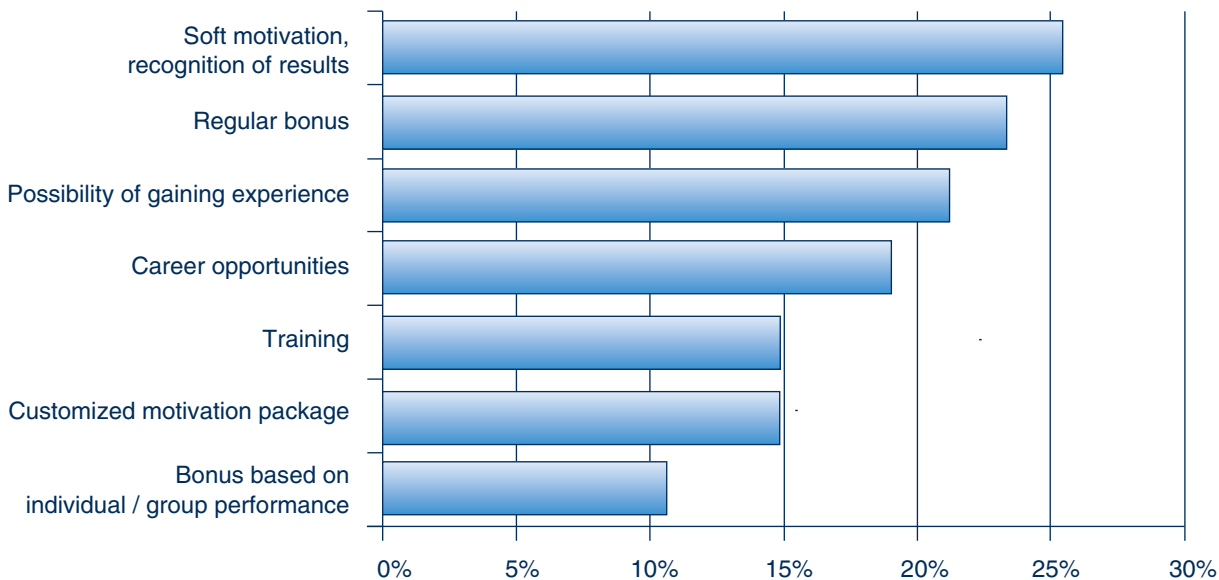
Which are the main hot topics from the following risk categories at the company?



Commentary

Effective company operation and the development of an appropriate control environment are the highest priority tasks based on the risk assessment of the Internal Audit departments that responded. 25% of respondents selected issues related to information technology as a key risk factor.

Motivation of Internal Audit staff

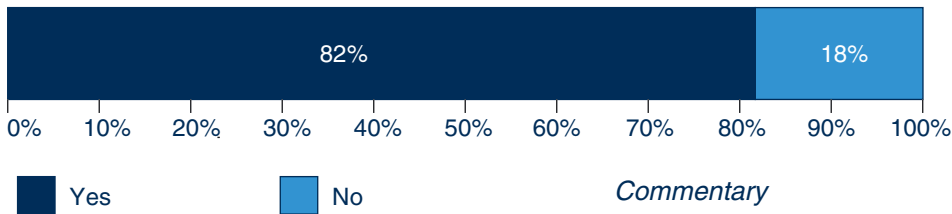


Commentary

The use of motivation tools is balanced among the respondent companies. Soft motivation and bonuses, together with the opportunities to gain experience, career-development and training are also used.

Working practices

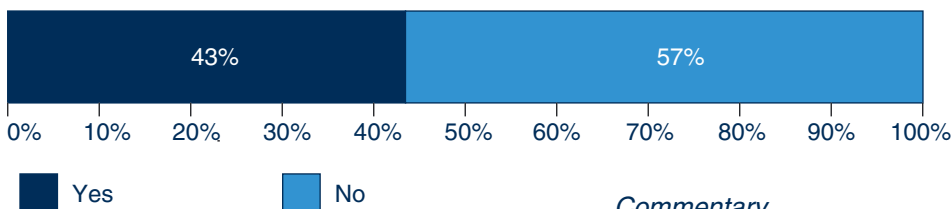
Does Internal Audit have a formal audit methodology?



Commentary

A formal Internal Audit methodology is available at 82% of respondent companies.

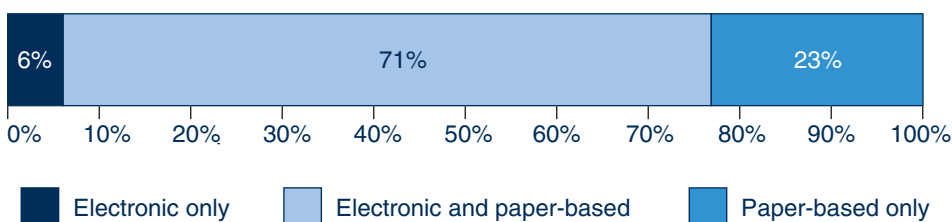
Does Internal Audit use up-to-date tools and methods?



Commentary

A relatively low 43% of respondents are convinced that they use the most up-to-date tools and methodology available.

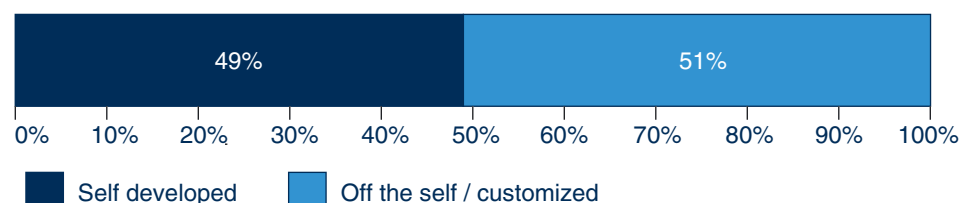
Technology used in audit documentation



Commentary

More than 75% of the companies use electronic working papers to facilitate audit work. Paper-based documentation is used in 94% of cases.

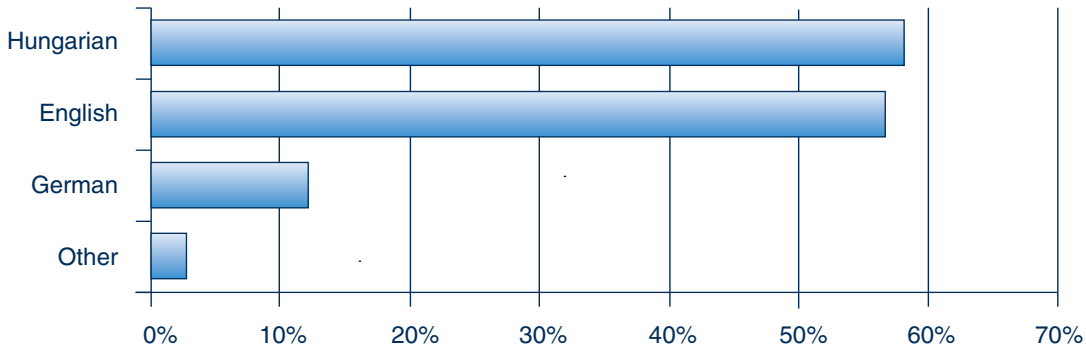
Types of software used in audit



Commentary

The types of software used are balanced: half of the companies develop software to meet their own needs; the other half obtains it from professional providers.

Language of the audit report

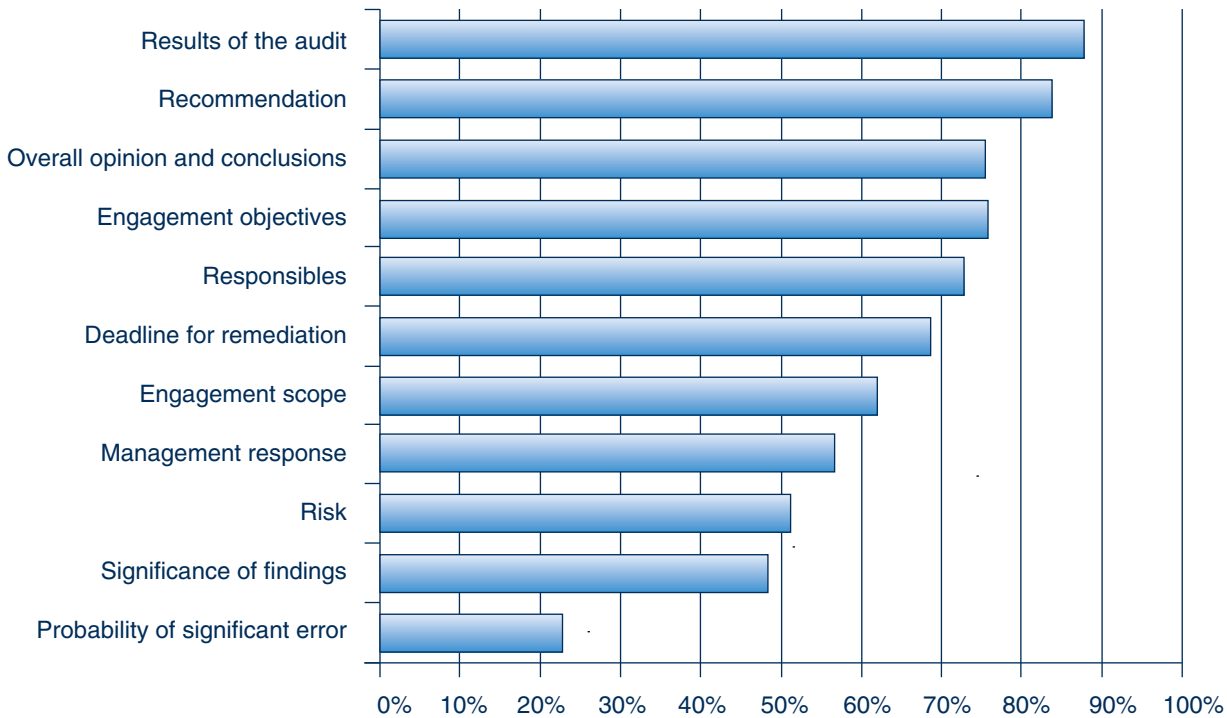


Commentary

Reports are prepared mainly in Hungarian and English (58% and 57%). 12% of respondents use German for reporting. Other languages constitute 2% of total responses.

Contents of the audit report

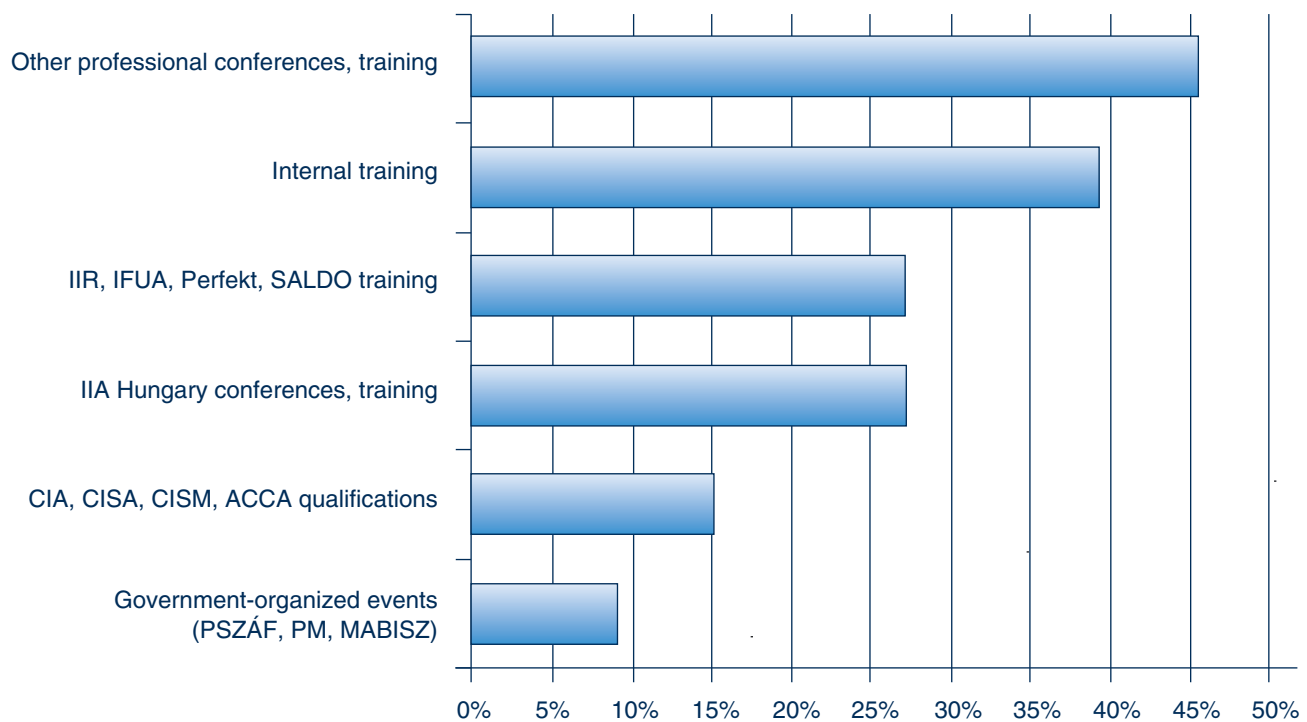
In percentages of number of respondents



Commentary

The topics less frequently included in the Internal Audit report are management response, risks, significance of findings and probability of a material error.

Sources of education in Internal Audit

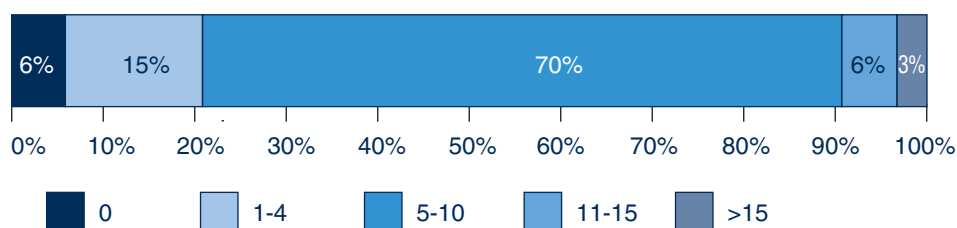


Commentary

Training provided by professionals is the most commonly used form of education in Internal Audit: by 73% of respondents. Conferences, training and courses organized by IIA Hungary, ISACA and ACCA are used by 42% of respondents.

Internal training also plays a significant part.

Days spent on education in Internal Audit



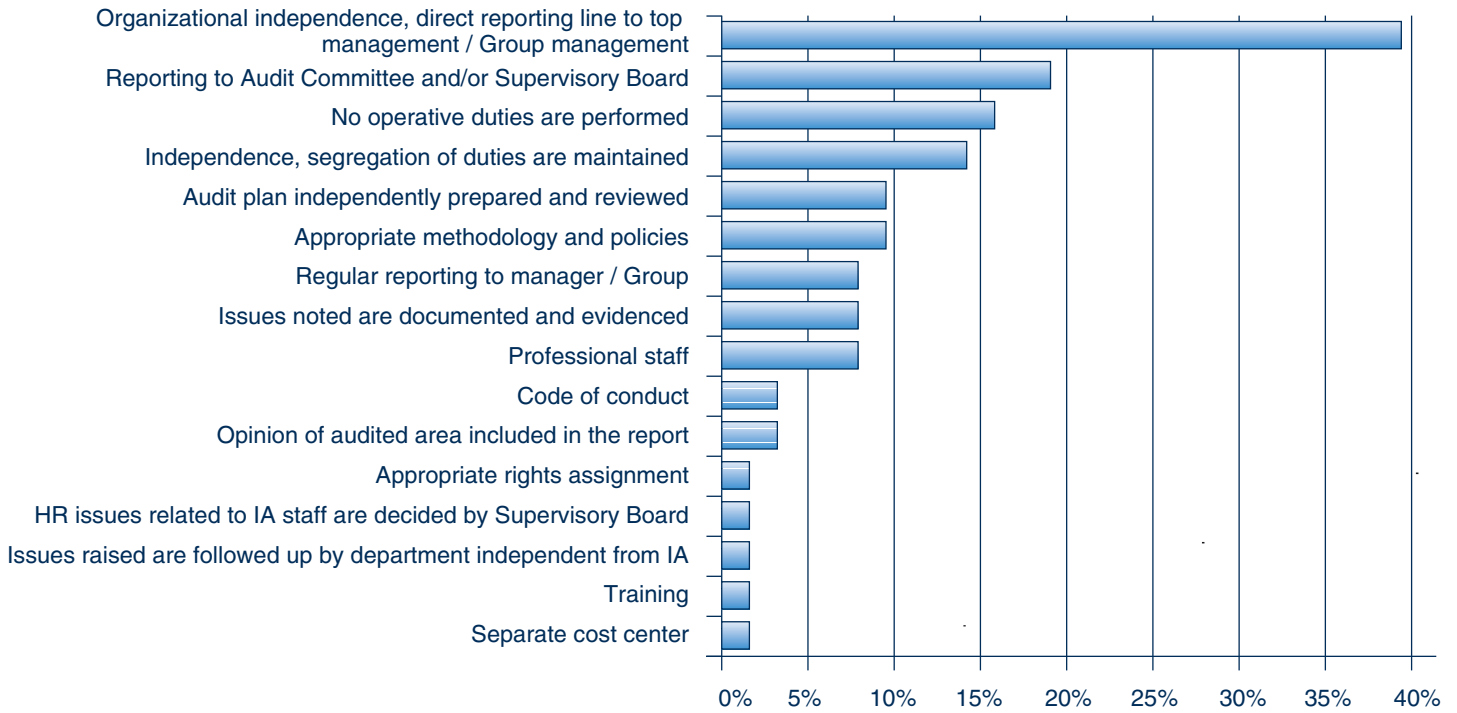
Commentary

The time spent on education is usually 5 to 10 days.

Independence and objectivity

Safeguards of independence and objectivity

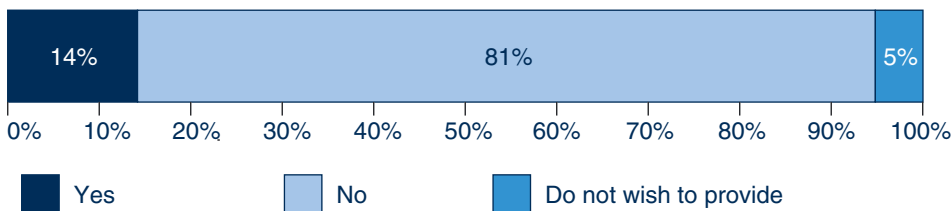
In percentages of total responses



Commentary

Most of the respondents (40%) think that organizational independence and direct reporting lines are the best safeguards for maintaining independence and objectivity. Reporting to the Supervisory Board and/or Audit Committee and segregation of operational duties and audit are also often indicated.

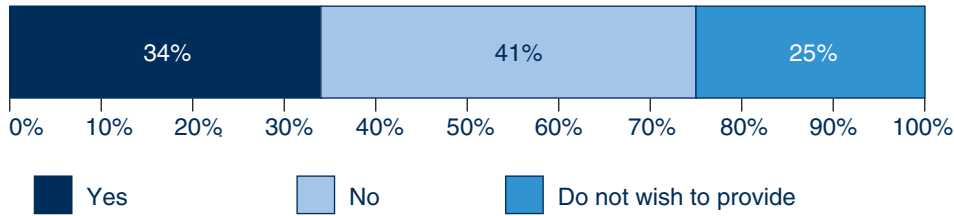
Has independence or objectivity of Internal Audit staff ever been impaired?



Commentary

The independence or objectivity of staff was impaired at 8 out of the 59 respondents.

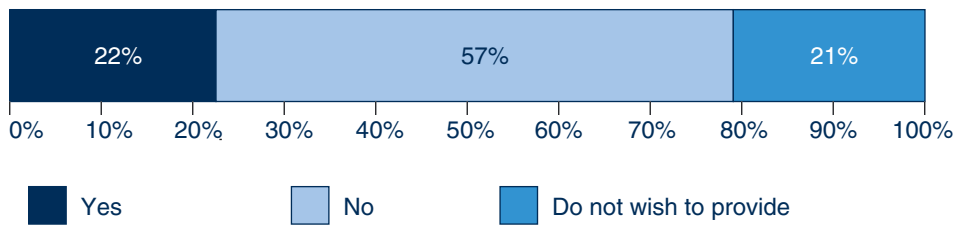
Are responsibilities of the Internal Audit leader controlled by a party outside the Internal Audit activity?



Commentary

The duties of the Internal Auditor and reviewer are segregated at only a relative low percentage (34%) of respondents.

Does performance evaluation depend on findings?

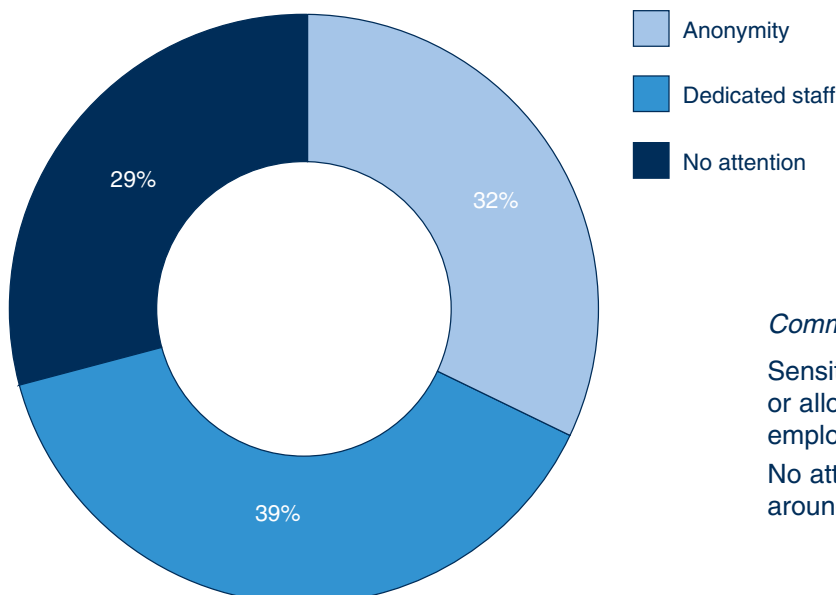


Commentary

At 22% of respondents, performance evaluation depends fully or partially on the number, significance or exposure of findings. Another 22% did not wish to provide information on this question.

How is sensitive data managed?

In percentage of responses received



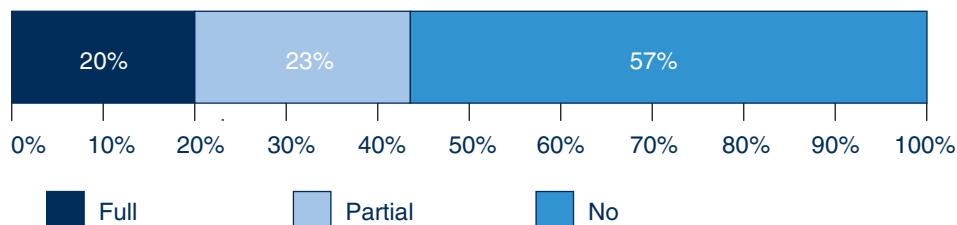
Commentary

Sensitive data is managed by either ensuring anonymity or allocating dedicated staff. Outsourcing is not employed at any of respondents.

No attention is paid to the handling of sensitive data at around 30% of organizations.

Internal quality programme

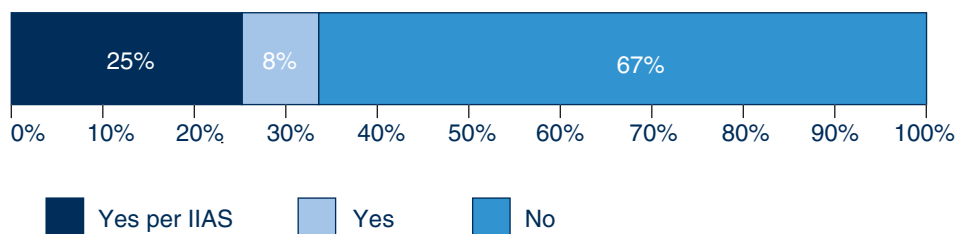
Does the Company comply with the IIA standards?



Commentary

Only 20% of the respondents believe that they fully comply with the IIA standards. More than half (57%) do not follow those standards or do not know if their practice complies with those standards.

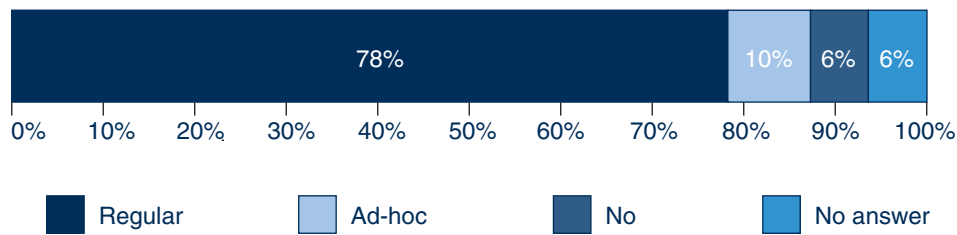
Is there a quality assurance program in place?



Commentary

Only one quarter of the companies that answered the survey state that they have a quality assurance programme which is in line with IIA standards.

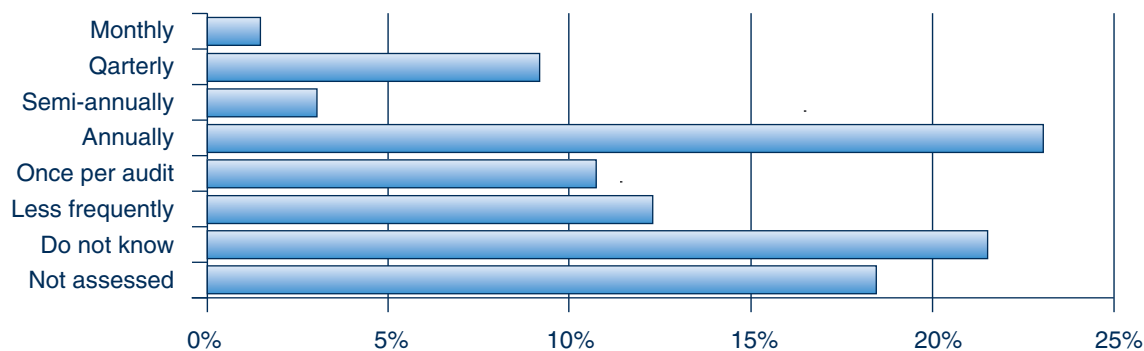
Is there a review of audit plan vs. completed work?



Commentary

At 12% of the respondents, no review of audit plan performance is ensured.

Is there a review of Internal Audit quality in place?



Commentary

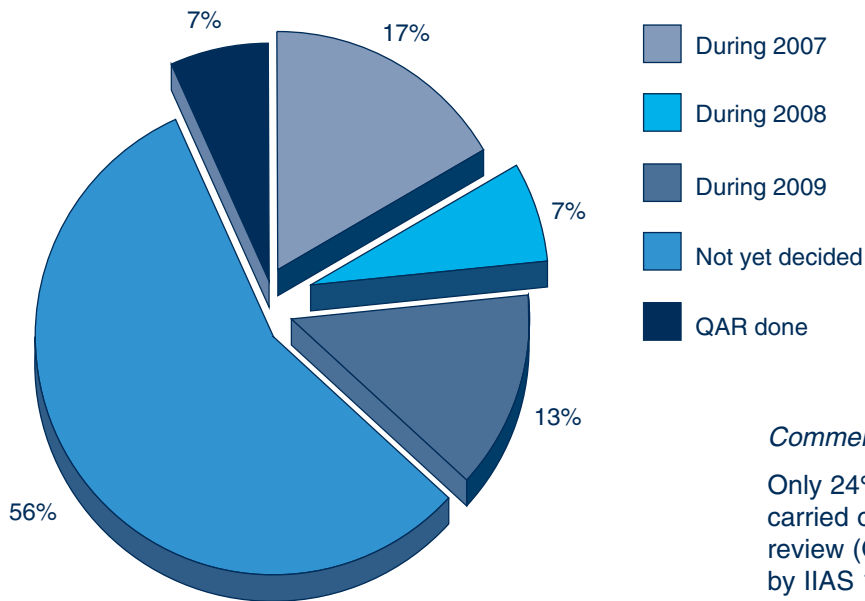
At more than half of the respondents, quality is not assessed at least yearly.

IIA standard 1311 requires the assessment of IA quality to include ongoing monitoring and periodic internal assessments of Internal Audit performance. Based on the results of the previous 3 questions, at least 50% of the companies reported non-compliance with IIAS 1311.

External quality assurance review

When are you planning on having a QAR?

In percentages of companies that plan to have QARs

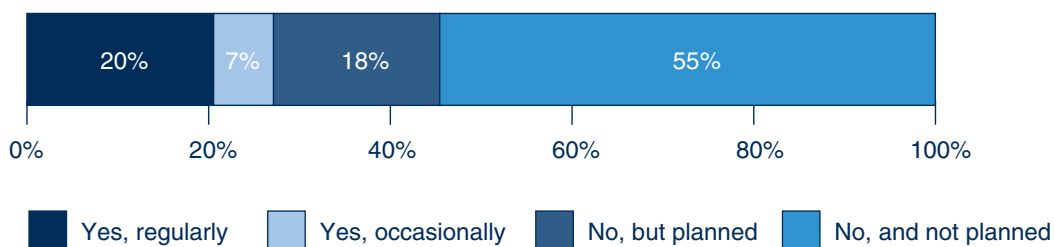


Commentary

Only 24% of respondent organizations have either carried out or plan to carry out a quality assurance review (QAR) of the Internal Audit function, as required by IAS 1312. Another 20% of respondents plan to carry out a QAR over the next few years.

Third-party involvement in quality assurance

Percentages of companies holding QARs



Commentary

45% of the respondents that hold QARs involve or plan to involve a third party.

Contact details

For further information on this survey and Internal Audit Services that we offer in Hungary and worldwide, please feel free to contact us:

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