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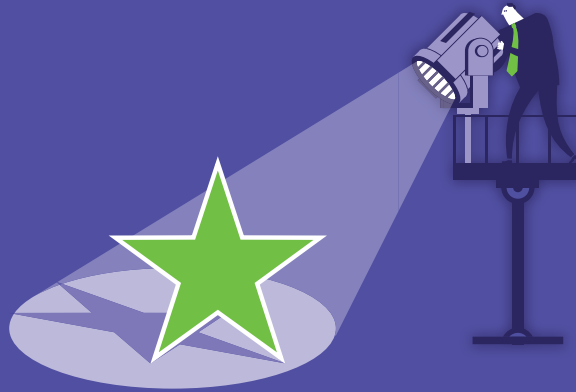
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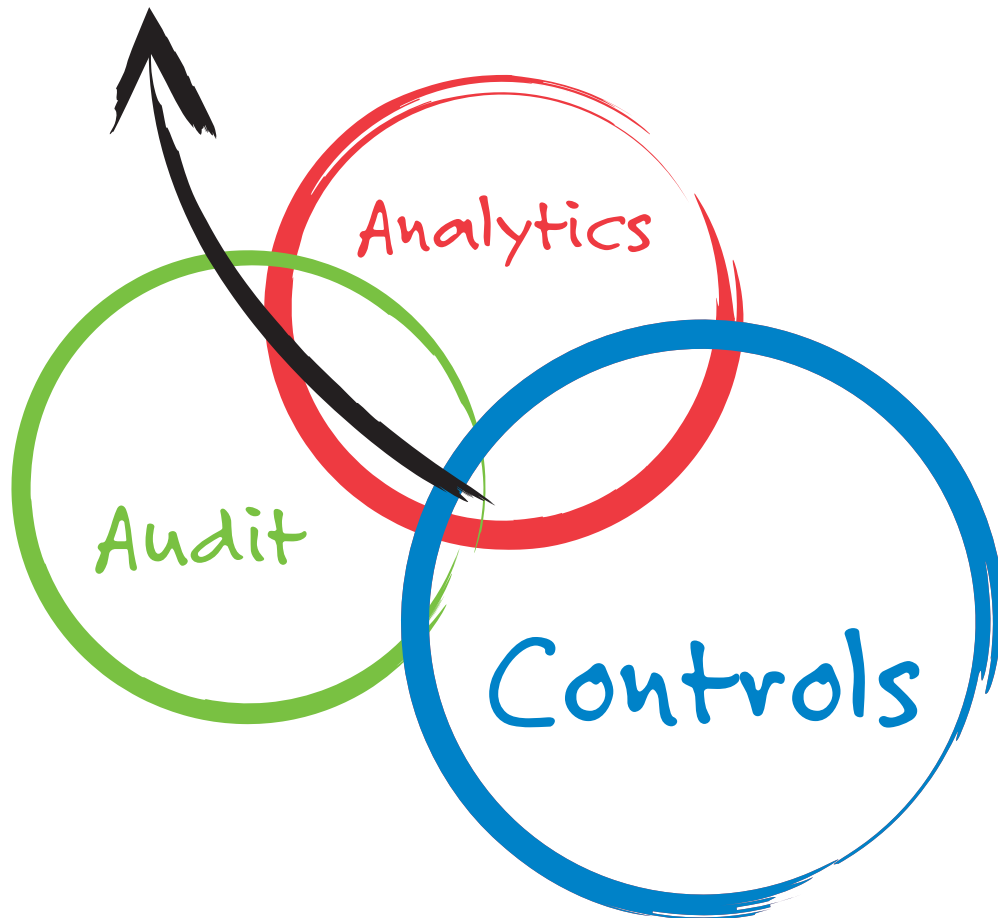
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Think Like a Leader

Leadership can be exhibited at every level of the audit function by practitioners who think strategically about the business.

Cybersecurity's Aftermath

Organizations are realizing that incident response must be a businesswide effort – not just an IT initiative.

Audit Committee Silence

In a video blog, IIA President and CEO Richard Chambers presents five topics the audit committee may not want to discuss.

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Like most magazines, we regularly survey our readers to ensure we're providing the content they want and need. The results of the recent 2014 *Internal Auditor* Magazine Survey are revealing, not so much because of what readers had to say about the content, but because of their lack of awareness of all *Internal Auditor* has to offer.

Although two-thirds of respondents indicate they access *Internal Auditor's* website at least monthly, one-third are not aware that it offers exclusive content, and many are unaware of the site's improvements since the redesigned site launched last August. Obviously, we haven't done enough to let our readers know the full scope of the *Internal Auditor* brand.

InternalAuditor.org features a new, mobile-friendly design, easier navigation, and an enhanced search function. The site, which has nearly 90,000 page views per month, also features content not found in the magazine, including blogs and videos from industry experts and articles related to technology, fraud, and other areas of interest to internal auditors.

Of those who visit the website, many are unaware of the **digital edition** (e-magazine) that is available on the site. The digital edition is an exact replica of the print edition with added features such as videos. By clicking on "View Current Issue" on InternalAuditor.org, readers can not only access the most recent digital edition, but also a digital archive that dates back to 2004.

The *Internal Auditor* **mobile app** also features the digital edition, as well as a daily news feed and our "Chambers on the Profession" and "Marks on Governance" blogs. The app is available for free download via the Apple App Store or Google Play. Search for Internal Auditor Magazine. Once an issue is downloaded, it can be viewed anywhere, anytime, regardless of wireless connectivity.

Finally, *Internal Auditor* is very active on social media. Our Twitter news feed, accessible via **@IaMag_IIA**, provides regular updates of the news important to internal auditors. The news feed also is viewable on InternalAuditor.org and as mentioned, on the app. Our followers on the *Internal Auditor* Magazine **Facebook page** receive internal audit-related information, as well as updates when new articles are posted to InternalAuditor.org.

In today's world, where people like to choose how they view content, it's important our readers know there is a lot more available to them than just the print publication. The *Internal Auditor* brand—print, website, digital edition, app, and social media—offers comprehensive coverage of the internal audit profession through a variety of mediums. Give them a try!

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■ CYBER SECURITY


Are You Protected?

From big data to outsourcing and services provided in the cloud, today's connected and global networks present complex challenges for IT and security professionals to manage. You recognize that traditional models of protecting your perimeter network systems are no longer sufficient, but may not know where to turn for the best solutions.

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“Fake President” Fraud

This type of scam was around long before social media. Con artists could get executive information from publicly accessible trade journals, and an urgent telegram with enough pertinent information would be sent with instructions to wire or transfer money immediately. Social media makes it easier to get the information, and email allows for quicker turn around to allow more time to take the money and run.

PHIL CASKANETTE comments on Alistair Beauprie’s “The ‘Fake President’ Fraud” (“Fraud Findings,” April 2015).

What Is a Risk?

A risk is only a risk if it has a probable impact on some aspect of the

objective. It is more useful for those aspects of the objective to be clearly articulated and risks to the objectives identified rather than to start by trying to identify risks. The key to risk identification is an acknowledgement that one cannot possibly identify all risks to an objective, especially in one sitting. Ongoing risk identification is one of the things internal audit should be looking for in assessing that process, rather than simply lambasting an engagement client for not having identified a particular risk.

KAYA KWINANA comments on the *From the Mind of Jacka* blog post, “Quit Looking for Unknown Risks.”

Root Cause

I’ve been in half a dozen audit groups, and one of the best things I’ve learned is the “5 Cs” basis of report writing. For any issue, we need to identify the condition (what was found?), the criteria (what is required?), the cause (why did this happen?), the consequence (what is the risk of doing nothing?), and the correction (what do we recommend?). However, there are usually several

contributing factors that may have helped form a given issue. Auditors not only have to be skilled enough to find out why an issue arises, but also disciplined enough to continue asking “why” until we discover the root cause.

RICHARD FOWLER comments on Mike Jacka’s “Cause Trumps Condition” (“The Mind of Jacka,” February 2015).

Reporting Responsibilities

Audit committees should continue to be more vigilant in the review of annual financial statements. Skilled members should perform appropriate and rigorous analysis and lead the discussions. Marks’ blog post suggests comparative analysis, and internal audit departments are ideally placed to deal with these analyses and report on the results to the committee. More importantly, the committee should understand, with the assistance of internal audit, the driving factors and risk universe of results-driven organizations, and focus on the accounting drivers that will influence those results.

SMARTRYK CALITZ comments on the Marks on Governance blog post, “Financial Reporting and the Audit Committee.”

Ia
INTERNAL
AUDITOR

JUNE 2015
VOLUME LXXII:111

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PUBLISHED BY THE
INSTITUTE OF INTERNAL
AUDITORS INC.

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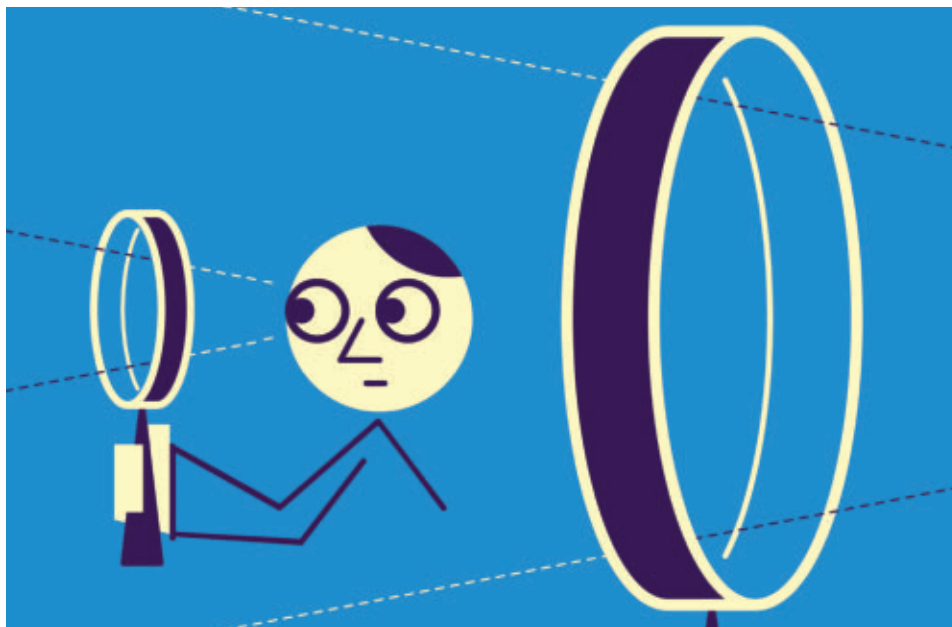
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Compliance guidance for health boards... U.S. accounting case filings up... CAEs and audit committees differ on risk... Hackers target health records.

Update



NEW COSO A WIN

Most U.S.-listed companies have implemented the 2013 update of the *Internal Control-Integrated Framework*.



Use updated COSO framework



Use original COSO framework



Did not disclose which framework company is following

Source: Protiviti Inc. analysis of publicly listed company filings through April 3, 2015

LOOKING FOR TALENT

Hiring challenges are a big cyberthreat.

Eighty-two percent of organizations expect to be victims of cyberattacks in 2015, and more than one-third of them are unable to fill open information security positions, according to State of Cybersecurity: Implications for 2015, published by ISACA and the RSA Conference. Less than half of the 649 cybersecurity and IT managers or practitioners responding to the global survey say their security teams are able to detect and respond to complex incidents.

A talent shortage and skills gap is the biggest culprit. Only 16 percent of respondents say at least half of the job applicants they receive are qualified, and 53 percent say it can take up to six months to fill an

opening. "If there is any silver lining to this looming crisis, it is the opportunities for college graduates and professionals seeking a career change," says Robert Stroud, international president of ISACA.

The U.S. government also is feeling the squeeze, according to a report from the Partnership for Public Services. In addition to the shallow talent pool, slow-moving hiring processes and low pay are working against it.

The partnership recommends exempting all cybersecurity job openings from federal competitive-hiring guidelines. Currently, the U.S. Congress has allowed the National Security Agency, the intelligence community, and the U.S. Department of Defense to

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69
NEW LAWSUITS
were filed last year alleging accounting violations,

UP 47%
FROM 2013,
with more than 25% of filings referring to an SEC inquiry or action.

60%
OF FILINGS
allege internal control weaknesses.

“The increase appears to be, at least in part, a result of the SEC’s heightened focus on accounting-related fraud,” says Elaine Harwood, vice president of Cornerstone Research.

Source: Cornerstone Research, Accounting Class Action Filings and Settlements – 2014 Review and Analysis

bypass hiring hurdles and adjust salaries to compete with the private sector.

When it comes to hiring a qualified candidate for a position, the ISACA/RSA report states hands-on experience is most important.

Security professionals continue to see a skills gap among hired professionals in the ability to understand the business (72 percent), technical skills (46 percent), and communication (42 percent). – **S. STEFFEE**

HEALTHY OVERSIGHT

Guidance advises health organization boards on compliance role.

Health-care organization boards of directors have an obligation to review the adequacy of compliance systems and functions, says a new guidance document. Practical Guidance for Health Care Governing Boards on Compliance Oversight is the result of a collaboration among the American Health Lawyers Association, the Association of Healthcare Internal Auditors, the inspector general of the U.S. Department of Health and Human Services, and the Health Care Compliance Association.

The document advises health-care boards to define the roles and relationships

among the audit, compliance, and legal functions. In addition, the board should ensure that the three functions all have access to appropriate information and resources, and that both the compliance officer and internal audit maintain their independence, the guidance stresses.

In terms of reporting, the guidance says boards should receive separate reports on the organization’s risk mitigation and compliance efforts from the internal audit, compliance, human resources, legal, quality, and IT functions. It recommends boards ensure that management and the board have processes in place to identify risk areas, management reviews and audits these areas, and management implements and monitors corrective action plans. – **T. MCCOLLUM**

OUT OF SYNC | Audit committees and audit executives don’t see eye to eye on risk priorities.

Audit committees and CAEs see internal audit priorities differently, according to a recent Grant Thornton survey of more than 500 U.S. CAEs and audit committee members.

The CAE respondents to the Governance, Risk, and Compliance survey rank compliance risks as the most important priority, followed by operational, financial, and strategic risks. Audit committee members rank

financial risks No. 1, above compliance, operational, and strategic risks. “The continued compliance-heavy environment makes it clear that internal audit must keep striving to rebalance priorities without leaving any key area or stakeholder



group behind,” says Warren Stippich, leader of Grant Thornton’s national Governance, Risk, and Compliance practice.

When asked to rank the top three areas in which internal audit can add value, CAEs listed identifying improvement opportunities, mitigating risk, and increasing efficiency. Audit committee members, however, ranked mitigating risk first, followed by strengthening financial control compliance



VISIT InternalAuditor.org to read an extended interview with Lee Barrett

and identifying improvement opportunities. CAEs say risk mitigation is the No. 1 area in which the board and management ask them to deliver value.

To better align with management and the board, CAEs should discuss their priorities and address barriers that may be preventing internal audit from delivering value, the report advises. CAE respondents identified barriers such as budget constraints (60 percent), talent quality or capacity (47 percent), a compliance-heavy focus (43 percent), and organizational politics (40 percent). – D. SALIERNO

HEALTH CARE TARGETED

Stealing medical records can be profitable for hackers, says **LEE BARRETT**, executive director of the Electronic Healthcare Network Accreditation Commission.



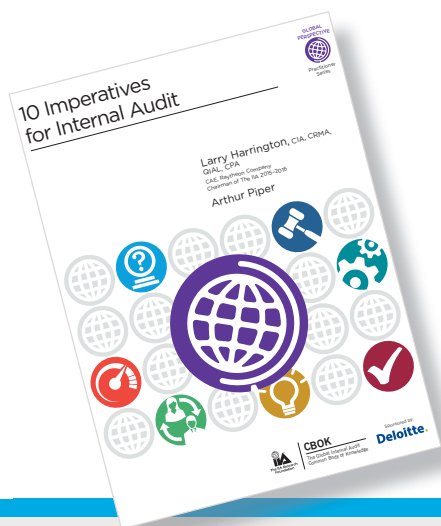
Why are hackers targeting health-care companies?

Individual patient records are loaded with private data that can be used for medical fraud, including buying drugs for resale and submitting false claims. We're not just talking about financial data, but also the details of patient diagnoses, treatment plans, and medications. Some estimates place the value of this information at US\$5 per patient record compared to US\$1 per credit card record.

How can internal auditors help boards turn their concern about cybersecurity into concrete action?

Internal auditors need to discuss with their boards not only the cost to recover from such an exposure but also the reputational risk from these types of incidents. They need to know what actions can be managed internally and when a third-party review is needed to objectively evaluate an organization's policies, procedures, controls, risk assessment, and intrusion detection.

First Report From the CBOK 2015 Practitioner Study: *10 Imperatives for Internal Audit*



10 Imperatives for Internal Audit will be the first of 30 free reports to be released based on the Global Internal Audit Common Body of Knowledge (CBOK) Practitioner Study.

The IIA will premiere this report at The IIA's International Conference in Vancouver, BC, Canada, July 5–8, and it will be available for free download at the CBOK Resource Exchange, www.theiia.org/CBOK.

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Back to Basics

BY JARED SOILEAU + LAURA SOILEAU EDITED BY JAMES ROTH

DELEGATION – THE KEY TO GROWTH

Sharing internal audit activities can make better use of limited time and create opportunity for improvement.

Ask any internal auditor how his or her day or week is going, and responses will almost certainly include, “I’m so busy,” “I wish I had more time,” or “There aren’t enough hours in the day.”

The combination of shrinking workforces, greater stakeholder expectations, and the productivity and concentration challenges associated with multitasking leave many internal auditors wishing there were more hours in a day. Because time is a fixed asset, internal auditors need to find ways to maximize it.

One approach is to delegate activities. For internal auditors who are new to a senior position or supervisory role, delegation is especially important.

Unfortunately, internal auditors offer some common excuses for not delegating activities, such as, “It will take less time if I do it myself,” “No one

can do it as well as I can,” and “No one else has the time either.” These excuses keep auditors from benefiting from one of the best time-management tools. And even though it requires a lot of up-front effort on the part of the delegator, when approached correctly delegation can allow for the growth of everyone involved in the process. Involving others can help develop their skills and abilities, so the next time a similar project arises, tasks can be delegated with confidence.

To determine if a task should be delegated, there are four key questions auditors should ask:

- » Can someone else do the task or is it critical for me to complete it?
- » Will it provide someone else the opportunity to grow and develop?
- » Will this or a similar type of task recur in the future?

- » Do I have enough time to delegate the task effectively (train, answer questions, check progress, and rework, if necessary)?

If the answer to two or more of these questions is “yes,” it is worth delegating the task using several steps.

Define the Task

It is important to clearly define the activity to be performed, including specific limitations, time frames for completing the activity, situations that require additional clarification (e.g., unusual circumstances that would require further discussion and direction), as well as a high-level picture of what “complete” looks like. Any specific formatting, style, or other such criteria to be adhered to should be identified at this time. Too often, internal auditors go into delegation without giving clear thought to the full scope of the activity and steps to be

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performed, decreasing the probability that the delegation will be successful.

Identify the Necessary Skills

When delegating, it is critical to understand the skills necessary to complete the task and determine who within the team exhibits those attributes. If a task is delegated to the wrong person, it is unlikely the task will be performed adequately and within the expected time frame. Further, the likelihood that similar activities will be delegated in the future also decreases. With that in mind, auditors should consider who may be best positioned to complete the activity within the established time frames and expectations.

Communicate Expectations

Clear expectations are not always established and shared with the delegate about the specific tasks to be performed. Common failures in communicating expectations may include:

- Not providing the reason the task must be performed.
- Providing direction that is too high level or vague.
- Providing guidance that excludes pertinent information, such as clearly defining the task to be completed and the time line to complete the activity.
- Not communicating the intended audience of the activity/deliverable.
- Not providing relevant background information.
- Not discussing in advance specific formatting, style, or other such criteria.

Delegation may be a struggle, and it may push people out of their comfort zones.

While it is important to clearly define expectations, it is also important to keep in mind the difference between personal preferences and mandatory business guidelines. For example, if there are no specific criteria for the formatting of a written deliverable, the work does not necessarily need to be redone if it comes back formatted differently than anticipated.

Ensure a Shared Understanding

In addition to communicating expectations for the task to be performed, it is important to ensure that the delegator and the delegate have a mutual understanding of that task. The person who will be performing the task should be encouraged to ask any clarifying questions necessary to better understand the activity, time lines, and any other

requirements. Further, the lack of questions should not lead the delegator to presume that the person who will be performing the task has a clear understanding of what is being asked of him or her. To increase the odds of success, after providing an overview of the activity to be performed, the delegator should consider having the delegate repeat back a summary of the activity to provide visibility into any areas in which the expectations may be unclear. This is also a good opportunity to provide examples of any unusual situations that may be encountered during which the delegate should come back to seek additional guidance. Face-to-face meetings are better suited than email to ensure there is a common understanding; such meetings allow the delegator to read the body language and facial expressions of the delegate to help identify any areas that may be unclear.

Monitor Progress

For all delegated activities, particularly those that may span multiple weeks or months, it is important to set regular checkpoints with the person who will be responsible for completing the task. These checkpoints can help ensure that the task is on schedule. In addition, checkpoints allow the opportunity for the delegate to ask any clarifying questions that may have arisen through the course of completing the activity. They also enable the delegator to confirm the task is being performed correctly, which is better to identify early in the process rather than at the last minute. Finally, checkpoints allow the opportunity to share any new expectations that have arisen over the course of the activity or re-establish existing expectations with the delegate.

Opportunity for Improvement

For the internal audit activity to best meet the needs of its stakeholders, it is important that all work throughout

the department is being performed at the most appropriate level. While delegation may sometimes be a struggle, and it may push both the delegator and delegate out of their comfort zones, it can give a fresh set of eyes to an activity that has traditionally been performed by one person or one role. This not only maximizes internal audit's limited time, but new insights can create opportunity for improvement all around.

JARED SOILEAU, CIA, CRMA, CISA, is an assistant professor of accounting at Louisiana State University in Baton Rouge.

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SIX AUDIT ANALYTICS SUCCESS FACTORS

Defining a process for data analysis can help auditors use the technology more effectively.

Data analysis technology has enabled many audit teams to achieve success and return on investment. A large car rental company transformed audit processes and reportedly reduced traditional audit work by 10,000 hours annually by using automated analysis to test all revenue transactions on an ongoing basis. Additional tests identified nearly US\$1 million a year in incorrect commission payments and multiple instances of payroll fraud that may not have been discovered through manual methods.

Data analytics has helped such organizations increase the productivity of the audit function and improve the quality and value of audit findings by giving auditors the ability to examine and test entire populations of transactions and balances that underlie an audit area. Because internal audit has access to processes and data from across the

organization, data analysis often enables auditors to provide insights into risk, control, and performance issues that no other function can provide.

Realizing the Benefits

Despite data analytics' benefits, most internal audit departments are still in the early stages of usage and are far from achieving their full potential. This often stems from a lack of understanding of what is involved in the audit analytics process. However, six success factors can help internal audit departments overcome obstacles and realize the benefits of analytics.

Strategy and Leadership

Many internal audit departments fail to make progress in implementing audit analytics because they do not treat it as a strategic initiative, overall objectives are unclear, and the department lacks necessary resources. Defining the

strategic objectives for audit analytics is a vital starting point. For example, The IIA's Global Technology Audit Guides 3 and 16 discuss how combining responsibilities for continuous auditing and monitoring can enable internal audit and the organization to achieve the strategic goal of continuous assurance. Moreover, using data analysis to support both audit objectives and management's maintenance of effective controls aligns closely with The IIA's Three Lines of Defense in Effective Risk Management and Control model.

The CAE's active support and involvement in an audit analytics implementation adds to its strategic importance and can help it deliver significant, sustainable benefits. The CAE should lead the effort by communicating the vision, strategy, and expectations.

Goals and Metrics Underlying the overall strategic objective, internal audit

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departments can establish specific objectives by prioritizing the expected benefits. Goals and metrics could include:

- ➔ Data analysis to be used on x percent of audits within a y-month time frame.
- ➔ Reduction in audit hours of x percent because of use of data analysis compared to the hours spent on the same audit using manual methods.
- ➔ Data analysis results in an x percent increase in positive feedback from audit client departments about value added by internal audit.

Establishing metrics and communicating progress helps align the audit team, provide a basis for managing the implementation process, and facilitate benchmarking with other organizations. It also can communicate value to senior management.

Planning and Project Management Audit analytics implementations often are undermined by poor management. As with any important technology-driven initiative, effective planning and project management are critical to success. A well-managed implementation program helps ensure the use of analytics is sustainable and not overly dependent on any one individual.

To achieve greater benefits, audit analytics needs to be integrated into the overall audit process. This means understanding at what point in the audit cycle different forms of audit analytics are best used. All members of the audit team

Developing a business case for analytics can identify costs and expected benefits.

should be aware of when and how audit analytics are to be used, together with their own role in the process. Audit analytics can be used in virtually every stage of the audit process, including audit planning and risk assessment, controls testing, substantive procedures, reporting and quantifying audit findings, and continuous auditing.

A Knowledgeable and Organized Team The success of implementing and maintaining an audit analytics program depends heavily on the extent of knowledge and skills available within the internal audit department and how the team is organized. Primary knowledge and skill requirements include:

- ➔ Data access and extraction.
- ➔ Design of analysis tests to meet specific audit objectives.
- ➔ Familiarity with using selected technologies.
- ➔ Understanding of the overall audit analytics process.

Training plans should reflect individual roles and related levels of knowledge. Those involved directly in data access and test development may require specialized training in specific software. Auditors performing simple analysis and tests may only require training in basic analysis concepts and introductory-level software usage. Managers and reviewers should be trained in audit analytics processes overall.


A variety of roles are involved throughout the analytics process, including data access specialist, data analysis specialist, and follow-up analyst to confirm any findings. Audit team leaders should understand how to best organize the different roles within their teams. In most audit departments, many of the roles may be combined in one or two individuals. In large departments, roles may be allocated across different team members, which allows for specialization and focus.

The Business Case for Resources Internal audit departments that achieve the most success in using analytics develop a business case to identify investment costs and expected benefits and to measure progress in achieving objectives. In compiling its case, the department should consider benefits such as reducing audit staff hours, increasing productivity, increasing the value of advisory findings for audit clients, and achieving cost savings or revenue gains. Potential costs include specialist resources and implementation assistance, software, training, and startup funds. The business case also can consider the effect of cost sharing with risk management, compliance, and other related functions.

Technology A wide range of data analysis software can be used to support audit analytics. Surveys indicate that

more internal auditors use Microsoft Excel for analysis than any other software. However, specialized audit data analysis software is also popular, especially in organizations that are more advanced in using analytics. Other analysis technologies can play a role, although these products may not support all aspects of the audit analytics process.

Leadership Is Key

Simply acquiring software and sending a few people to a training course is not a recipe for success. Data analysis can help transform much of the audit process for the better, but it takes leadership, vision, commitment, and management execution to achieve sustainable benefits. 

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A BOOST TO FRAUD RISK ASSESSMENTS

Reviews based on the updated COSO *Internal Control-Integrated Framework* may help prevent fraud.

Daily headlines of pilfered passwords and stolen credit card data have put fraud at the top of management's risk management agenda. This concern coincides with new guidance in The Committee of Sponsoring Organizations of the Treadway Commission's (COSO's) 2013 update of the *Internal Control-Integrated Framework* that directs organizations to conduct a fraud risk assessment as part of their overall risk assessment.

Now is an opportune time for internal auditors to help their organization re-examine its approach to fraud risk. For organizations that have not formally documented processes and controls to address fraud risk, adopting COSO 2013 can jump-start a fraud risk prevention program. Organizations that have a more mature fraud risk assessment can use it to strengthen their fraud prevention processes and procedures.

COSO's Guidance

The discussion of fraud in COSO 2013 centers on Principle 8: "The organization considers the potential for fraud in assessing risks to the achievement of objectives." Under the 1992 COSO framework, most organizations viewed fraud risk primarily in terms of satisfying U.S. Sarbanes-Oxley Act of 2002 requirements to identify fraud controls to prevent or detect fraud risk at the transaction level.

In COSO 2013, fraud risk becomes a specific component of the overall risk assessment that focuses on fraud at the entity and transaction levels. COSO now requires a strong internal control foundation that addresses fraud broadly to encompass company objectives as part of its strategy, operations, compliance, and reporting.

Principle 8 describes four specific areas: fraudulent financial reporting, fraudulent nonfinancial reporting, misappropriation of assets,

and illegal acts. The inclusion of nonfinancial reporting is a significant change that covers sustainability, health and safety, employment activity, and similar reports. Because internal auditors frequently provide assurance in this area, they can provide insights into fraudulent nonfinancial reporting.

One useful document for performing a fraud risk assessment is *Managing the Business Risk of Fraud: A Practical Guide*, produced by the American Institute of Certified Public Accountants, the Association of Certified Fraud Examiners, and The IIA. This guide to establishing a fraud risk management program includes a sample fraud policy document, fraud prevention scorecard, and lists of fraud exposures and controls.

Fraud Risk Governance

Managing the Business Risk of Fraud advises organizations to view fraud risk assessment as part of their

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corporate governance effort. This commitment requires a tone at the top that embraces strong governance practices, including written policies that describe the expectations of the board and senior management regarding fraud risk.

But even organizations with committed senior leadership may have inadequate fraud risk assessment programs. Most organizations have some written policies to manage individual fraud components, but many don't concisely summarize these documents and activities so they can communicate and evaluate the completeness of their fraud management processes. Internal audit can help with this evaluation and address the areas of fraud described in Principle 8.

The Assessment Process

Although a fraud risk assessment should ordinarily be conducted as part of a broader evaluation of organizational risk in an enterprise risk management program, it may initially be done on a stand-alone basis. Regulatory and legal misconduct, such as U.S. Foreign Corrupt Practices Act violations, as well as reputation risk, also should be considered. Internal auditors can help ensure the fraud risk assessment is sufficiently robust.

Assess and Identify Inherent Risk The fraud risk assessment starts with a brainstorming session to uncover the organization's potential fraud risks, without consideration of mitigating controls. The review should be shaped by the organization's operating environment, including industry practices, business culture, the state of the economy, applicable regulatory regimes, business practices, and business conditions.

Each risk area should be examined, including fraudulent reporting, possible loss of assets, and corruption. The assessment should consider:

- All types of fraud schemes and scenarios.
- The incentives (such as compensation programs), pressures (such as a chief financial officer who needs to hit an earnings estimate), and opportunities (such as a senior executive with override ability) to commit fraud.
- The IT fraud risks specific to the organization, which may become pervasive without appropriate controls.

Additionally, the fraud risk assessment needs to consider the potential bypass of controls, as well as areas where controls are weak or there is a lack of segregation of duties.

Assess Likelihood and Significance of Fraud Risk This review of identified fraud risks should be based on staff interviews—including business process owners—known fraud schemes, and historical information, both internal and external to the organization. In assessing fraud risk significance, organizations should consider not only exposures to assets

and financial statements, but also risk to their operations, brand value, and reputation, as well as criminal, civil, and regulatory liability.

Fraud Prevention and Detection

Fraud prevention requires both preventive and detective controls, but the Managing the Business Risk of Fraud guide points out these are not mutually exclusive: "If effective preventive controls are in place, working, and well-known to potential fraud perpetrators, they serve as strong deterrents to those who might otherwise be tempted to commit fraud. Fear of getting caught due to a company's known commitment to punishment is always a strong deterrent. Effective preventive controls are, therefore, also strong deterrence controls."

Segregation of duties in small organizations can be difficult because of limited resources and personnel. These organizations need compensating controls such as periodic budget-to-actual analysis at a precise-enough level to flag and investigate unusual activity.

Fraud Investigation and Corrective Action

The fraud investigation and response system should include a process for categorizing issues, communicating within the organization—including with the audit committee or those charged with governance—conducting the investigation and fact-finding, monitoring the status of fraud cases, and resolving the investigation with a recommendation for prosecution. Standards, regulations, or laws may require parties such as legal counsel, the board, the audit committee, and external auditors to be notified if the allegation involves senior management or affects the financial statements.

An Opportunity for Improvement

Organizations that already have adopted COSO 2013 can continue to build on that foundation to prepare for the fraud challenges ahead. For those organizations that haven't yet implemented the framework, the opportunity to improve their fraud risk assessment should motivate them to adopt it soon. In either case, internal auditors who are well-versed in COSO 2013 can help the organization's fraud risk assessment initiative by facilitating the assessment itself or helping align policies and fraud mitigation activities.

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Fraud Findings

BY JOHN HALL

CHARITY BEGINS IN THE HOME

A well-liked employee's fake vendor scheme nets her US\$600,000 over three years.

It was a hot Friday afternoon in the Atlanta airport. John Rigby's flight was delayed four hours, and he wanted to fill that time productively. He remembered he still had an unresolved audit exception on a routine match of vendor and employee addresses. The match was for the supervisor, Marilyn Bell, at his client's graphics department only a few miles away from the airport.

After a 15-minute taxi ride, Rigby opened the door to the small office and announced himself.

"I'm an outside contractor for the audit team at headquarters," Rigby explained to Bell. "I just need to follow up on an exception we had on some routine audit testing of vendor files last month. Tell me a little about your supplier, Charity Smith."

The blood drained from Bell's face as her eyes started watering. Rigby knew he was on to something.

"Tell me what happened," Rigby instructed.

"Charity is a longtime friend of mine since high school," Bell began to explain. "She's a single mom with two young children, and she helps me out from time to time when we have excess work and tight deadlines."

During the course of his conversation with Bell, Rigby learned a lot about Smith. During the last three years, when the need arose for new print materials—from training manuals to quarterly product catalogues to promotional posters and banners—Smith was often called on to handle the design work.

Smith worked from her home office, often clocking late night hours so she could better juggle the demands of client work and caring for her children. She sent her finished work and weekly time sheet by email, which were reviewed by Bell, approved by Bell's manager, and sent to accounts payable for payment.

After listening silently for almost 10 minutes, Rigby thanked Bell and asked one follow-up question: "Why are Smith's payments mailed to your home address and deposited into your checking account?"

Bell replied without any hesitation, "Charity lives out in the country, and with taking care of the kids all day she has a hard time getting to the bank in the nearest town to make her deposits. It's an hour of driving round trip to get to the bank and back, so once a month I deposit her checks into my account, withdraw the cash, and meet her half way for coffee and to give her the money."

Bell said she had always intended to speak to her boss about the arrangement, just to make sure he was aware of the situation, but she never got around to it. Rigby asked her to write down everything she told him. He explained that he needed something for his

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audit files to explain the exception, and that her write-up would take care of that.

As Bell wrote, Rigby called a manager in charge of the office from the next room and asked for permission to send Bell home. They agreed and called a manager from another office in Atlanta to come immediately to assist Rigby.

Bell wrote a 12-page report and confirmed verbally and in writing that it was all true. Before sending Bell home, Rigby asked her to get Smith on speakerphone so she could corroborate the report. Again, the blood drained from Bell's face and her eyes teared up. She froze at the request.

Nonverbal reactions can indicate that a fraud is likely occurring.

Bell said she did not have the phone number with her in the office, so Rigby suggested she quickly drive home and get it so they could call Smith together in the office. Bell didn't move.

Rigby realized that during the car ride, Bell could call someone to help her by pretending to be Smith, but it was a calculated risk that paid off. Bell continued to sit still and stare at the desk.

"It's not true, is it?" Rigby inquired, while holding up Bell's written statement.

"No," she answered. "I made it all up to cover the amount I've taken from the company."

Rigby then called the office manager back and asked him to pull Bell's personnel file and look for any other addresses she had provided, regardless of how old they were or why they might be in the file. Two more matches with vendors were found—her parents' address and her boyfriend's business address (he was her emergency contact). The total paid to the three fake vendors over three years was almost US\$600,000.

Bell's boyfriend's address was a retail store. Further investigation revealed that he was taking the checks mailed to his business and to Bell's parents' address and including them in the store receipts for the day. An identical amount of cash was removed from the deposits. He was later charged and found guilty of money laundering.

Bell began her scheme to recover from extreme pressures at home after a messy divorce. She fell months behind in her mortgage payments, and she and her children were going to lose their home. Once she put her ethics aside to get up-to-date on her mortgage, she found it much easier to do it again to meet other needs that came up in her life.

These included a new car, paying off credit cards and a US\$25,000 line of credit, new clothes, vacations, and a custom home with expensive high-end finishes and a custom spa room.

Bell's manager was held responsible for signing dozens of fabricated time sheets and invoices from the three fake vendors. He trusted Bell and never checked the details.

Bell agreed to cooperate with the investigation and to make restitution. Her parents mortgaged their paid-off house to help, and her church took up a special collection as well. Just before her trial, Bell agreed to a plea arrangement that kept her out of jail.

Lessons Learned

- Fake vendor schemes are common. Procurement teams will assure they have adequate controls over new vendors, but fraudsters will tell you exactly how—and how easy it is—to circumvent those controls.
- Address matches are a standard audit test. Unfortunately, they often lead to false positives and inefficient follow-up work. But auditors shouldn't let down their guard. There's a reason why procedures like this are so standard—they produce that needle in a haystack that deserves immediate attention. Auditors should always check every address they can find related to that person to see if they have been busier than first suspected.
- Even well-liked, trusted employees can perpetrate fraud. Bell's work was excellent—she was reliable and she always went the extra mile to serve her many in-house graphics clients. But financial pressures at home caused her to come up with a scheme to help her pay the mortgage and, eventually, finance a lavish lifestyle.
- Nonverbal reactions can often indicate that a fraud is likely occurring. Bell's surprise at Rigby's visit and her attempt to cover her tracks with a complicated story about her fictitious friend were clumsy and full of obvious holes. Auditors should make a point to follow up on audit exceptions in a way that they can see the face of the person as they ask. Get trained in what to look for at this critical moment.
- The command, "Tell me what happened," can be used to pivot from an audit query to a fraud-based interview. Don't set limits on the subject matter or time frame. Let the interviewee decide where to begin the story and what details to include.

JOHN HALL, CPA, CBA, has been a speaker and trainer at IIA conferences and chapter events for more than 25 years.

Beyond the FCPA

Strong internal controls and effective internal audit are critical factors in global anti-corruption efforts.

Jonathan T. Marks
Thomas R. Fox



R

Recent aggressive, anti-bribery actions by various governments are indicative of new challenges that businesses with global operations or supply chains are encountering. Although the U.S. Foreign Corrupt Practices Act (FCPA) has been the preeminent anti-corruption law for most companies with international operations or financial ties, in recent years other countries have become assertive in enforcing their own regulations, further complicating an organization's governance, risk management, and compliance efforts (see "Sharper Focus on Foreign Bribery" on page 30).

This growing complexity reinforces the importance of a system of strong internal controls backed by an effective, independent internal audit function. An internal auditor supplies to an organization's governing body and senior management comprehensive assurance that anti-bribery controls are in place, designed appropriately, and operating as prescribed.

The *International Standards for the Professional Practice of Internal Auditing (Standards)* points out that although internal auditors are not expected to have the expertise of a person whose primary responsibility is detecting and investigating fraud, they must possess the requisite knowledge to evaluate the potential for fraud—including corruption—to occur, along with the methods the organization uses to manage fraud risk. Enforcement actions by authorities in several nations provide valuable insight into the tools, processes, and procedures regulators expect organizations to follow to manage fraud risk. By reviewing such actions in the context of recent global anti-corruption trends, internal auditors can build the knowledge needed to meet their professional responsibilities.

GROWING ROSTER OF ENFORCERS

The U.S. has pursued foreign bribery cases more actively than other countries in recent years. U.S. authorities imposed sanctions against individuals and companies in 128 foreign bribery

cases during the 15-year period covered by the Organisation for Economic Co-operation and Development's (OECD's) 2014 Foreign Bribery Report. Germany sanctioned individuals and companies in 26 cases, South Korea imposed sanctions in 11 cases, and Italy, Switzerland, and the U.K. each imposed sanctions in six cases. Four anti-bribery laws are notable.

U.S. The authority for most U.S. anti-corruption cases is the FCPA, which applies to all U.S.-based businesses, citizens, and residents. Moreover, the FCPA also governs any "U.S. issuer," a broad term that encompasses all foreign companies trading on U.S. exchanges as well as any other company that is required to file periodic reports with the U.S. Securities and Exchange Commission (SEC). It also applies to foreign subsidiaries of U.S. companies and U.S. subsidiaries of foreign companies.

In addition to the anti-bribery requirement, publicly traded companies are subject to FCPA accounting provisions that mandate that the books and

records accurately reflect all transactions and internal control provisions that require companies to have appropriate internal controls to prevent, detect, and remedy FCPA violations. Internal audit has a separate role in testing the books and records, as well as in assisting with designing and implementing internal controls and then testing them.

German-based Siemens AG and Daimler AG, U.K.-based BAE Systems, France's Total S.A., and Japan's JGC Corp. are among the prominent companies that have been required to pay steep FCPA-related fines in recent years. As of the end of 2014, eight of

the 10 largest penalties imposed by the U.S. government in FCPA cases were assessed on companies headquartered outside the U.S. Moreover, the *Latin American Law & Business Report* newsletter notes that, "foreign individuals and foreign companies that do not trade on U.S. exchanges can also violate the FCPA if they cause an act in furtherance of a corrupt payment within the U.S."

U.K. Several other countries' laws are even broader in scope. For example, the U.K.'s Bribery Act of 2010 applies to a wider range of companies and makes a greater array of conduct illegal than the FCPA does. It has authority over any company that engages in any business or part of a business in the U.K. In addition to prohibiting the bribery of both government officials and nongovernment individuals, the Bribery Act penalizes the bribe receiver, not just the bribe payer, as the FCPA does.

The U.K. act also prohibits *de minimis* "facilitation payments" for certain routine government actions that do not provide the payer with an unfair competitive advantage. A common example is the payment of a fee to speed up installation of telephone service by a state-owned telephone company. Practices such as this, regarded as a routine cost of doing business in some countries, are afforded an exemption under the FCPA but not under the Bribery Act.

Canada In 2013, changes Canada made to its Corruption of Foreign Public Officials Act aligned it more closely with the FCPA. However, in some respects, such as the prohibition of facilitation payments, the Canadian law is more similar to the U.K. Bribery Act.

Brazil Also in 2013, Brazil's congress passed the Clean Company Act, which went into effect in January 2014. It is similar to the FCPA in that it targets

SHARPER FOCUS ON FOREIGN BRIBERY

In its 2014 Foreign Bribery Report, the OECD observed that "enforcement of anti-bribery laws has drastically increased" since the organization's Convention on Combating Bribery of Foreign Public Officials in International Business Transactions took effect in 1999. The report examined 427 cases of bribery involving foreign officials over the past 15 years. Prison sentences were handed down to 80 individuals in connection with those schemes, and another 38 individuals received suspended sentences. Sixty-nine percent of the cases in the report were settled by sanctions imposed through plea agreements, nonprosecution agreements, corporate probation, or similar settlement arrangements.

Altogether, 261 individuals and companies were fined, the report notes. The highest combined fine against a single company totaled US\$1.95 billion, while the highest monetary sanction against an individual amounted to US\$149 million.

Clearly, the stakes are high, but as OECD Secretary-General Angel Gurría notes in the report's preface, "With bribes averaging 10.9 percent of the total transaction value, and combined monetary sanctions ranging from 100 percent to 200 percent of the proceeds of the corrupt transaction in 41 percent of cases, the business case against corruption is clear."

Another factor behind today's greater focus on corruption is the updated *Internal Control-Integrated Framework* released in 2013 by The Committee of Sponsoring Organizations of the Treadway Commission (COSO). Among the 17 principles spelled out in the revised COSO framework is the requirement that an organization consider the potential for fraud when it is assessing risks associated with the achievement of its objectives. These include possible acts of corruption by the organization's personnel, outsourced service providers, and other third parties.

CEOs and other corporate managers paid or authorized bribes in 53% of foreign bribery cases, and 57% were paid to win foreign procurement contracts, OECD's Foreign Bribery Report finds.

only public corruption and not commercial bribery. But other aspects, such as those covering defendants' state of mind and knowledge, are more similar to the U.K. Bribery Act.

The Brazilian law is particularly significant in that companies—not just individuals—are now subject to prosecution for bribery. Companies found guilty could face fines of up to 20 percent of their gross annual revenue, along with possible suspension of operations, confiscation of assets, and even dissolution. The law covers both bribery of foreign officials by Brazilian companies and bribery of local officials by any company.

The Clean Company Act also spells out a particularly strong oversight role by a company's internal audit function. Under the law, having strong compliance programs in effect is not an affirmative defense against corruption charges, but authorities can consider compliance efforts to reduce penalties. These compliance efforts can be evaluated on three factors: 1) the structure of the program, including reporting mechanisms, training, policies and procedures, and periodic risk assessments; 2) specifics about the legal entity, including specific compliance risks; and 3) an evaluation of the program's efficiency, including a case-by-case verification of the program's effectiveness by internal audit.

HIGH-PROFILE ENFORCEMENT ACTIONS

In addition to expanding their statutory authority, governments are undertaking more vigorous anti-corruption enforcement actions. Several recent cases provide useful insights into the internal controls that must be in place and internal auditors' responsibilities for helping their organizations maintain compliance.

GlaxoSmithKline PLC (GSK) One of the highest-profile actions in recent



An xin - Imaginechina via AP Images

China fined GSK a record US\$491 million—the amount of the alleged bribery—and the former top GSK executive in China and six other people received criminal convictions.

years has been an ongoing corruption investigation in China. The case culminated in September 2014 in the conviction of U.K.-based GSK for paying bribes to boost its business. China fined GSK a record US\$491 million—the amount of the alleged bribery—and the former top GSK executive in China, four other company managers, and two ancillary GSK-hired investigators received criminal convictions.

The Chinese government's entry into the international fight against corruption and bribery is a game changer. Foreign companies are now on notice: Doing business the old way will no longer be tolerated, and companies operating in China have a new risk to

consider—possible prosecution under domestic Chinese law.

The Chinese example also could encourage additional anti-corruption enforcement around the globe. When other countries with endemic corruption issues see that they can attack their domestic corruption issues by prosecuting international businesses operating within their borders, there may be an appetite for additional prosecutions.

The GSK case also offers lessons about the potential cost of internal audit failures. Ironically, as various news sources have noted, GSK had more compliance officers in China than in any country except the U.S. and has conducted up to 20 internal audits a year in China. Nevertheless, the

company was unprepared when Chinese officials accused it of using travel agencies to funnel bribes to doctors and officials under the guise of medical conferences and other events.

Although the cost of monitoring such payments would be high and would involve the tedious work of verifying numerous receipts and scrutinizing countless transactions for signs of fraud, the use of practices such as GSK's to hide payments to doctors was a well-recognized risk. One lesson internal auditors can draw from the case is clear: If the risks for a certain pattern of corruption are well-known, a company must devote whatever resources are necessary to verify its compliance with relevant laws.

Avon Another case of bribery allegations involved cosmetic maker Avon

Products Inc. According to settlement agreements with the SEC and the U.S. Department of Justice, the company's Chinese subsidiary paid US\$8 million in bribes to Chinese officials in 2004 in the form of cash, gifts, travel, and entertainment. The purpose was to gain access to officials who were drafting and implementing new direct-selling regulations in China.

The Avon case demonstrates the high cost of a failure by the internal audit function—in this case fines and investigative costs of more than US\$500 million. The bribes reportedly were detected by Avon's internal audit function in 2005 and 2006, but the company's CAE at the time was persuaded to withdraw the internal audit report and destroy all evidence. This information was never presented to Avon's board, which learned of the corruption only because of an internal whistleblower.

Petrobras The GSK case in China might be a harbinger of international anti-corruption enforcement actions based on domestic anti-bribery laws, but a case now underway in Brazil could turn out to be even larger. In fact, the investigation into Brazil's state-owned energy company Petrobras eventually could become the world's largest corruption investigation.

Petrobras CEO Maria das Gracas Foster and five board members have been forced to resign, and Brazilian President Dilma Rousseff has come under pressure because of her former role as minister of energy and president of the Petrobras board. The company's former head of refining operations has told prosecutors that construction budgets for new projects were routinely inflated by 3 percent of their value to cover bribes and kickbacks, some of which were then routed to major Brazilian political parties. Another defendant has testified that more than a dozen of Brazil's largest construction companies paid bribes to obtain contracts.

The case also has significant global implications. In addition to banks in Switzerland and the Cayman Islands, where funds allegedly were deposited, companies ranging from shipyards in



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Avon paid US\$8 million in bribes to Chinese officials in 2004 in the form of cash, gifts, travel, and entertainment, according to settlements with the SEC and the U.S. Department of Justice.

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Petrobras CEO Maria das Gracas Foster and five board members have been forced to resign, and Brazilian President Dilma Rousseff has come under pressure because of her former role as president of the board.

Singapore to U.K.-based Rolls-Royce plc also have been accused of paying bribes.

Although the allegations in the Petrobras case occurred before the passage of Brazil's Clean Company Act, the prosecution of the case is being watched closely for any precedents that could affect the new law's implementation.

INTERNAL AUDIT'S APPROACH

Examples such as Avon, GSK, and Petrobras can provide useful lessons for internal audit functions to help their organizations fight bribery and corruption. The IIA practice guide, *Auditing Anti-bribery and Anti-corruption Programs*, recommends internal audit assess the effectiveness of anti-bribery and

corruption programs to help anticipate the risk and identify the existence of potential and actual incidents.

Two different, but complementary, approaches may be used, either separately or together: 1) auditing each component of the anti-bribery and corruption program, and 2) incorporating an assessment of anti-bribery and corruption measures in all audits, as appropriate. With the latter approach, bribery and corruption risks are incorporated into the risk assessment and scoping process of each audit. This process may:


- Include procedures to assess bribery and corruption risks.
- Evaluate potential bribery and corruption scenarios.

- Evaluate the control environment and anti-bribery and corruption programs in that audit area.
- Link the scope of an audit area's procedures to its assessed risks.

In some situations, management may not want internal audit's findings about potential corruption brought to the board's attention. This is why any compliance program must include structural protection that allows internal audit to share its concerns with the board or, at a minimum, the audit committee.

Moreover, it is a best practice in compliance programs for the board or audit committee to seek out and ask the tough questions about whether internal audit has uncovered any evidence of FCPA violations. There must be internal audit independence, an independent reporting channel to the board, and board fulfillment of its role in a compliance regime.

CORRUPTION FIGHTERS

Internal audit's role in anti-bribery and corruption programs depends on an organization's governance structure. In addition, internal audit's level of involvement should be recommended by the CAE and approved by the board. In all cases, however, it is critical that the function has the independence from senior management necessary to report directly to the board when violations of law are uncovered. By adhering to the *Standards*—and by understanding and applying the lessons from recent enforcement actions—internal auditors can be better prepared to provide the crucial third line of defense against fraud and corruption. 

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Partners in Assurance

A good relationship with the audit committee can enable CAEs to better satisfy its members' expectations.

Russell A. Jackson

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he relationship a CAE maintains with the company's audit committee is foundational to his or her success in that position, but that relationship doesn't exist in a vacuum. The forces at play inside and external to that relationship can help improve it—or can sour it. But while there's no recipe for developing a good audit committee relationship, there's one simple strategy for overcoming the obstacles: communication. CAEs shouldn't make assumptions about what the audit committee needs or wants, and shouldn't let external influences exert undue control. They should simply state their case and listen when the audit committee responds.

Olivia Kirtley, president of the International Federation of Accountants and audit committee chair at Papa John's International, ResCare Inc., and US Bancorp, points to two factors outside the CAE's control that can dramatically affect his or her relationship with the audit committee: the professional maturity of the parties and the growing recognition of internal audit's importance. "Every company is at

a different state of maturity with regard to the relationship,” Kirtley says. “To the extent the CAE and the audit committee chair have more experience with what works well, you tend to see relationships that are strong and improving. Experience really plays a key role.” And when the culture of the company recognizes the critical functions performed by internal audit, the CAE’s relations with the committee tend to improve, as well.

Also central to a CAE’s relationship with the audit committee is the nature of the reporting relationship between them; and there’s an aspect of the reporting relationship that the CAE can’t always control: the audit committee’s trust. CAEs can’t simply

will such trust to life, but they can communicate their concerns. “If I felt the committee chair didn’t trust me, I’d be open, honest, and candid,” says Marc Woodward, director of internal audit at Hallmark Cards Inc. in Kansas City, Mo. “I’d say, ‘Tell me what it takes for us to have an open, trusting relationship.’ If there’s no trust, I can’t be his eyes and ears.”

Christy Decker, vice president of internal audit services at Sharp Health-Care in San Diego, sets the tone for her reporting relationship with the audit committee from day one with orientation for each new member. The new member, the CEO, and Decker meet to review examples of the reports they’ll receive and walk through the meeting’s

structure and time requirements. That orientation allows for input, feedback, and questions at the outset, which has eliminated push-back from committee members. After orientation, Decker resumes ad hoc meetings with the chair and with other members—including occasional lunches. “Members change, and new members have different levels of internal audit expertise,” she comments. “Listen to their feedback and help them as much as possible with questions along the way.”

SETTING THE PARAMETERS

A challenge from within is the reality that there is no formula for calculating how much information the CAE should provide to the audit committee. In almost

AN UNCOMFORTABLE RELATIONSHIP

For many CAEs, the external factor that has the most negative impact on relationships with the audit committee is management. And it’s not always because management and the audit committee have different expectations of internal audit. Many times CAEs find themselves in a difficult position when, for example, their CEO is uncomfortable with the CAE’s tight bonds with the audit committee chair or other board director.

Indeed, many CAEs have horror stories of meddling executives who seem to fear the CAE’s close relationship with the board. Of course, such meddling can negatively impact that relationship. “I’ve been flat out told that I had to tell management everything I was telling the audit committee,” says Cathy Young, who has served as CAE for five companies. “A CEO insisted I copy him on all correspondence with the audit committee. I said, ‘You’ve got to be kidding me.’”

CAEs can work around the problem by keeping the three-way lines of communication open among the CAE, the board, and management, and by shoring up the audit committee’s trust so that if things get ugly, the CAE knows the chair has his or her back. “At the end of the day, it’s important that the CAE consider both the CEO’s and the audit committee’s perspectives,” notes Alan Siegfried, an audit committee member at Mid-Atlantic Farm Credit in Westminster, Md., and an adjunct graduate professor at the University of Maryland. He says he’s aware of CEOs who require CAEs to rehearse their upcoming conversations with audit committees and cautions against letting that become the norm.

CAEs shouldn’t leave management out, though. Melissa Frazier, vice president, audit and controls, at Comfort Systems USA in Houston, assures audit committee members that “there’s nothing I’m going to tell you that I can’t talk to—or haven’t already talked to—management about.” In fact, when her committee asks her company’s external auditors whether they trust the internal audit function for the unvarnished truth, they always answer, “Absolutely.” When nobody’s talking behind anybody’s back, there’s no worry about superiors feeling they’ve been deceived or, perhaps worse, left out of the loop.

40% of audit committee members are **satisfied** the internal audit function delivers value to the organization, according to the KPMG Audit Committee Institute's 2015 Global Audit Committee survey.

every instance, an organization's audit committee looks to its CAE for interpretation of the data he or she presents to it. Serving as the committee's eyes and ears often requires some analysis to make what's seen and heard make sense.

But some CAEs get themselves in trouble by bringing too much opinion and too little data to enable the audit committee members to make their own decisions about the risks the organization faces. That can come off as abrasive and ego-driven. But there's also the potential for too little opinion. "You do have to put some things in context," so the committee knows whether an issue is a one-time concern or a structural matter that needs board-level attention, notes Melissa Frazier, vice president, audit and controls, at Comfort Systems USA in Houston. "I present the facts," she says. "If they want to know my opinion, they ask. But I try to keep the discussion focused on the processes, whether they're working or they're broken."

Absent a playbook for CAE-audit committee relationships, internal audit leaders need to provide enough information to facilitate the committee's effective completion of its required tasks. If committee members want refinements to that information, they need to ask for it. Once the informational parameters are established, CAEs need to make sure they're staying within them, and that requires precision in the delivery of internal audit services.

"Know what audit committee members expect and deliver," says Kevin Cantrell, vice president, internal audit at Plains All American Pipeline, an oil and natural gas company based in Houston. "Not too much. Not too little. Be on target." He accomplishes that by setting an agenda for each audit committee meeting—in consultation with the audit committee chair—that, at a minimum, includes updates from financial accounting,

external auditors, internal audit, and risk management.

DUAL EXPECTATIONS

Audit committees generally know what they want from internal audit; their expectations aren't always realistic, but committee members have an agenda they expect the CAE and his or her team to follow. That's complicated by the fact that there's an external force that bears on that relationship: The CAE also often reports to management, usually the CEO or chief financial officer. This executive also has specific, valid expectations of internal audit that often don't resemble those of the audit committee (see "An Uncomfortable Relationship" on page 36).

In general, audit committees look for compliance with company policy, generally accepted accounting principles, and IT security mandates, among other areas, Woodward says. The audit committee, he explains, "has a fiduciary responsibility to make sure that the company's exposure to risk is at an acceptable level, and that includes making sure i's are dotted and t's are crossed." Toward that end, the committee seeks formal assurance of management's skill at wielding controls to effectively manage risk. Management, in most cases, is much more focused on ways internal audit can add value to the business and help it grow revenues.

Each entity wants both functions to be carried out—management wants internal audit to cover compliance; the audit committee doesn't want to snuff out the department's value-added activities—but neither may be aware of how important the other's preferred function is. "Most management, outside of executive-level management, does not know about the audit committee's differing expectations," Woodward explains, "because they don't have much interaction with the committee." At the same time, he adds, the audit committee



Listen to new audit committee members' feedback and help them as much as possible with questions."

Christy Decker



I try to keep the discussion focused on the processes, whether they're working or they're broken."

Melissa Frazier



“sees the value-added activity and may wonder why you spend so much time on it, so I explain that it’s also a part of our job. They’re all for that.”

sending too much information, or sending it in the wrong way. Do they send every audit report and expect board members to read all of them?

Making the audit committee’s job easier should be the CAE’s goal.



“I ask the audit committee, ‘What can I do better to make you more effective?’”

Marc Woodward

Indeed, he says, when internal audit departments really try to serve both masters, relations between CAEs and audit committees tend to work out just fine. “Work hard to make sure compliance is where it needs to be, so the audit committee is comfortable, but remember that in every audit and in every interaction with other parts of the business, one goal is to add value,” Woodward comments.

TIPS FOR GOOD RAPPORT

Communication underlies almost every aspect of the relationship between CAEs and their audit committees, and internal audit practitioners cite robust communication over and over as the key element to a good rapport between the two parties. “It keeps coming back to communication,” Decker says. “You have to keep in contact and allow for open, flowing communication. Be a great communicator. And keep smiling.”

Take the Initiative If CAEs want to know how to improve their relationship with the audit committee, they should ask. “Every quarter, when I have a session with the audit committee, I ask, ‘Am I giving you the information you need?’” Woodward says. “‘Too much? Too little? What can I do better to make your job easier and make you more effective?’ Don’t try to guess. Ask.”

Focus on Details as Needed CAEs should ask the committee if they’re

That may be too much. Should the reports contain more graphics and more color? They may not be holding the committee members’ interest. “Develop a trusting relationship and they’ll tell you,” Woodward says. “I’m very open to that, and I ask for it.”

Discover Their Needs CAEs should remember that reports are designed for committee members to use, not for CAEs to show their expertise and comfort with details. That disconnect may explain part of audit committees’ frequent complaint about internal audit failing to meet their information and assurance needs. “It’s good to ask the committee members if you’re meeting their needs and if there’s anything you can do to improve their understanding of the information,” Kirtley suggests. “When you ask for input like that, you’re showing that you’re there to service them with what’s best for them—rather than just giving them what you think they want you to produce.”

Make Things Easy If audit executives follow the business maxim “Service your boss,” then making the audit committee’s job easier should be the CAE’s main goal. “Everyone always hears about the workload of the audit committee, how much members are expected to do, and the amount of material they’re expected to cover,” Kirtley says. “Anything you can do

to make their job easier is a way to enhance that relationship.”

It's All About Risk CAEs need to ask audit committees which risks they're most worried about and how they want to see those risks addressed in the reports they receive. “Risks change, and new ones arise, like cyberrisks,” Frazier says. “Let the committee know we see there's something there to address.”

Moreover, CAEs should work to continuously educate committee members on risks they may not be aware of. “One thing the CAE can do is help the audit committee understand the key risks—including the emerging risks—in the organization and thus better understand the company's risk profile,” says Alan Siegfried, an audit committee member at Mid-Atlantic Farm Credit in Westminster, Md., and an adjunct graduate professor at the University of Maryland.

Training Is Key Audit committee members are chosen for attributes

YRC Worldwide Inc., a global shipping company based in Overland Park, Kan. Moreover, he says “some general training sessions on emerging issues and hot topics would be valuable.” It behooves CAEs to ensure audit committees understand the entire palette of services internal audit provides, including those services management may focus on more than the department's financial and compliance activities.

Practice Humility as Appropriate

“If the committee says something's not working, the CAE needs to be big enough and professional enough to say, ‘That's my fault,’” Woodward advises. “The CAE needs to own up to it, always.” It's okay for CAEs to note that they were trying to make a positive change, but if the chairman wants something done differently, they need to do it. “I want the chair to be efficient in his job,” he adds.


Communicate Regularly CAEs should ensure their audit committee

along to an audit committee meeting. Some firms just say no—the CAE doesn't have a choice. Other CAEs choose not to bring a staff member. “I always do the presentation myself,” Woodward says. “Meetings are pretty compact, and having a second person can add complication and take time off the agenda.” Instead, his managers meet with the committee chair once a year, just so he knows who they are and they know him.

Other CAEs are accompanied by staff members as appropriate. For example, bringing staffers is helpful for committee members when “someone is the lead internal auditor in the IT area, and the audit committee has an interest in an IT audit,” Kirtley notes. Interaction with committee members also might facilitate succession planning in the internal audit department by grooming a candidate for future advancement.

COMMIT TO BASIC TASKS

CAEs and audit committees don't conduct their business together in a vacuum. Outside parties actually have an enormous impact on their relationships, especially the outside parties who can hire and fire the CAE. Moreover, external forces beyond anyone's control, such as the experience of the committee members at working together with internal audit, may determine the productivity of the relationship more than the simple determination of the CAE and the audit committee members to make the relationship work.

Still, as with most professional relationships, strengthening the ties between CAEs and audit committees requires commitment to three basic tasks, Cantrell notes. “Ask questions,” he advises. “Understand and address their concerns. Do outstanding work.” It's that simple. 

RUSSELL A. JACKSON is a freelance writer based in West Hollywood, Calif.

CAEs should ensure audit committees understand the entire palette of services internal audit provides.

other than their expertise with the fine points of internal audit, so CAEs should respond accordingly. “Usually the members of the audit committee are not experts in governance, risk management, compliance, and internal controls,” Siegfried says. “The CAE really needs to be an educator in that regard.”

CAEs should educate newer audit committee members on general governance topics such as how controls are developed, audited, and improved, says Rick Wright, director, internal audit, at

“face time” isn't confined to audit committee meetings. “You've got to have some kind of regular communication set aside beyond what's part of the audit committee meeting schedule,” Wright urges. “Organizations where there hasn't been that kind of access seem to have less functional and positive relationships.”

Consider Bringing Staff When they can, CAEs should make their own choice about bringing a staff member

Internal Audit in the Crosshairs

Several key strategies can help CAEs address challenges associated with organizational politics.

Patricia K. Miller
Larry E. Rittenberg

Illustrations by Sandra Dionisi

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rganizations are, by definition, political. They're composed of people who have different goals, value systems, sources of motivation, and approaches to meeting objectives. Internal audit, with its broad mission and unre-

stricted scope, is subjected to many of these often-conflicting factors. This reality, combined with the potential for audit results to reflect badly on some individuals—or bring attention to issues that some would prefer not be shared—creates a potentially substantial risk of political pressure for the CAE.

How much of an issue is political pressure? According to a recent survey of CAEs conducted by the authors—as presented in *The Politics of Internal Auditing*, published by The IIA Research Foundation (IIARF)—55 percent of the nearly 500 participants say they were directed to omit or modify an important audit finding at least one time, with 17 percent indicating it happened three or more times. Nearly half say they were directed not to perform audit work in an area that the CAE viewed as high risk, and 32 percent were told to perform work in a low-risk area so that an executive could investigate or retaliate against another individual.

Political pressure may be overt or subtle. Some CAEs from the IIARF study say they were asked to take early retirement, or lateral transfers in the organization, and some were even fired. Other, more subtle actions included changing the scope of internal audit and decreasing budgets or head counts. Nearly every CAE interviewed had at least one experience he or she attributed to political pressure, often speaking of it as a “defining moment.” Most CAEs, in fact,



WEAK GOVERNANCE SPELLS TROUBLE FOR INTERNAL AUDIT



A new CAE was hired at a governmental agency following the previous CAE's departure over conflicts with management. The agency granted various types of licenses to other organizations and maintained a zero-tolerance policy for bribery.

Shortly after taking the helm, the new CAE became aware of a significant and likely ongoing bribery situation involving a key agency employee. The CAE knew the issue was important and determined that it should be reported to both management and the board, consistent with legal requirements and agency policy.

A strong-willed CEO led the agency and dominated the board. There was no audit committee. When the CAE indicated the need to report the bribery to the board, the CEO and the chief legal counsel rejected the idea. Their rationale included:

- » It's not a big deal—paying these bribes is no different than providing a tip at a restaurant.
- » The board would not be interested in this situation, nor would it understand the context.
- » The board would not know enough to judge risks, and reporting the events would create confusion.
- » Everyone would look bad if the situation became known.

Nonetheless, the CAE continued to insist on issuing a report. Negative consequences ensued, including the threat of a personal investigation from the human resources director and exclusion from organizational meetings and functions. These actions had a personal impact on the CAE, who had trouble sleeping and suffered family stress because of the long working hours and pressure of trying to meet professional obligations.

After seven months, the CEO agreed to formally report the problem to external authorities. A prosecutor was presented with the evidence, and the employee was indicted for accepting bribes. Neither the CAE nor the CEO reported the incident to the board directly, although the board became aware of it due to the legal action.

Excerpted from *The Politics of Internal Auditing*.

will experience political pressure in the organization at some point in their career. Fortunately, numerous key practices and skills can help avoid, mitigate, or deal with these pressures.

COURAGE, CREDIBILITY, TRUST

To be effective and credible, CAEs must be willing to identify and explore difficult issues, collect sufficient evidence to support conclusions, discuss the conclusions—even in conflict—and maintain an unwavering stance when others apply pressure. If CAEs do not adhere to their principles, they lose credibility and most likely will experience the same political pressures repeatedly. Practitioners need to define the line and criteria whereby they resolve to stand their ground. “Weak Governance Spells Trouble for Internal Audit” on this page provides an example of a public sector CAE's courage and firm stance in the face of significant political pressure.

CAE participants in the IIARF study offered several suggestions for maintaining credibility, respect, and trust:

- ➔ **Raise the right issues.** CAEs must understand the organization; strategies, objectives, and priorities; and associated risks and mitigation activities to effectively judge the significance of issues identified.
- ➔ **Listen fairly and objectively, but remember your ethical compass.** While remaining independent, CAEs must be open to hearing the other side and considering the views and rationale of those who disagree with internal audit.
- ➔ **Build and maintain a strong team.** A strong, professional team understands The IIA's *International Standards for the Professional Practice of Internal Auditing*; knows how to plan, execute, and document audits; demonstrates professional skepticism; collects sufficient

evidence; takes pride in the quality of its analyses; and remains calm and poised under fire.

- ➔ **Provide fact-based conclusions with clear business implications.** Internal audit must clearly establish the factual audit results—they should not be subject to disagreement. However, management may disagree with the impact of those results and the CAE's subjective conclusion. When presenting results, internal audit needs to be effective at identifying and communicating the impact of its findings and focus on business implications.
- ➔ **Play on the same team as management.** Several CAEs noted that it is never a bad idea to remind a manager who adamantly disagrees with an audit observation that both parties are on the same team. Demonstrating how audit findings relate

One-third of CAEs say they were excluded from key meetings after refusing a political request, and 18% reported loss of opportunities, according to *The Politics of Internal Auditing*.

to organizational objectives helps defuse challenging situations and earns long-term credibility.

ANTICIPATING PRESSURE AND UNDERSTANDING MOTIVES

Effective CAEs from the IIA study say they consider how they will handle political pressures before they actually occur. Some suggest having a discussion with the audit committee and the CEO about potential pressures and developing an understanding of the role of the audit committee in such situations.

CAEs who say they successfully navigate political risk also often have a decision framework for stressful situations. They think ahead to identify decision criteria that are relevant and important. One CAE respondent shared criteria for determining when to quickly escalate a finding:

- ➔ Any time lives may be in danger.
- ➔ Any time there is a significant reputational risk to the organization.
- ➔ Any time it is financially material to the organization.

When an important business issue is identified, members of the internal audit team should also determine who is involved and what would concern them if they were in that role. Understanding other perspectives can help identify approaches to mitigate political risk.

KEY RELATIONSHIPS

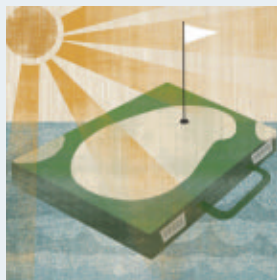
The personal relationship among the CAE, the audit committee chair, and the CAE's administrative report is a critical factor in dealing with political pressure. A solid relationship built on quality work, demonstrated business acumen, shared objectives, reasoned judgment, and impeccable integrity means executives are much less likely to distrust or dismiss a CAE who raises valid concerns. Organizational knowledge that the board and CEO support

internal audit may preempt pressure from occurring.

When meeting with executives and the board, CAEs should go beyond routine interactions. Respondents to the IIA study shared several suggestions,

ranging from quick and informative reporting to developing programs that help the board or audit committee members better understand new risks—or even leading educational programs on emerging topics such as the

CEO EXPENSES: PERSONAL OR BUSINESS?



The CEO at a major U.S. manufacturer had adopted a lifestyle that he felt was commensurate with his role as a company executive. During an audit of customer-related expenses, internal audit found that nearly US\$1 million of the CEO's personal spending was billed to the company inappropriately. The expenses included vacation trips for the CEO and his

spouse and parties at his home.

The organization's CAE reported functionally to the audit committee and administratively to the chief financial officer (CFO). The CEO was a strong figure who had placed like-minded individuals in officer roles, ultimately leading to a team of "yes men" who believed their first job was to protect the CEO. Moreover, the company had recently experienced a major change in governance with considerable turnover on the board, including the loss of a very supportive audit committee chair who was replaced with one who had less interest in internal audit.

The CAE shared the expense-audit findings with the CFO, who in turn discussed them with the CEO. The CEO subsequently offered to pay back the expenses, but estimated the amount due to be a small fraction of internal audit's finding. The CFO wanted to accept this payment, close out the audit, and inform the audit committee—without a special report. But the CAE continued to push for full repayment, based on the team's detailed analysis of the data.

Eventually, full repayment was made. Less than a year later, however, the CAE was asked to move to a different position and was subsequently "eased into retirement" after more than 20 years at the company. The CAE believes these actions were taken in retaliation for the expense audit.

When sharing this story, the CAE expressed amazement at how quickly corporate culture can change with a shift in senior leadership. For many years, the CAE said, the organization had a positive culture with strong values. But the tone at the top deteriorated rapidly, and management began focusing on protecting individuals instead of the company and its stakeholders. The CAE emphasized the need for preparedness in anticipation of such change. Despite having a passion for the organization, the CAE considered changing jobs after the shift in tone at the top, but ultimately took the early retirement offer instead.

Excerpted from *The Politics of Internal Auditing*.

EXECUTIVE WITCH HUNT



At a major retailer, the CEO asked the CAE to audit an executive's travel and entertainment expenses. Upon asking what prompted suspicion of policy violations, the CAE was told there were no known or suspected breaches. Instead, the CEO said the executive was ineffectual and hoped internal audit would find evidence to support termination.

After examining the situation, the CAE determined that an audit was not warranted. The motives for the audit seemed unethical and would divert audit resources from risk-based work. The CAE declined the CEO's request and advised that it conflicted with internal audit's overall purpose to provide independent assurance that governance, risk management, and internal control processes are operating effectively. The CAE also recommended addressing the performance issue through the company's established performance improvement protocols.

When relating this account, the CAE pointed out that buckling under political pressure invariably undermines the internal audit function's ability to live up to The IIA's definition of internal auditing and to its *International Standards for the Professional Practice of Internal Auditing*. It would also undermine internal audit's credibility and its ability to stand up to future pressures that may be exerted. The CAE added that this type of pressure directly conflicts with the concepts of independence and objectivity; internal audit's commitment to taking a systematic, disciplined approach to gather and analyze evidence; and its ability to address key risks and help the organization achieve its objectives.

Excerpted from *The Politics of Internal Auditing*.

impact of implementing a new internal control framework.

CULTURE AND TONE AT THE TOP

A weak ethical culture, generally due to poor tone at the top, significantly increases the risk of political pressure. Ethical weaknesses could stem from a narrow focus on growth, market share, or earnings, and a willingness to bend the rules to achieve metrics. Or it could simply be the result of a senior executive who cannot accept looking bad.

A strong ethical culture can change rapidly—especially when a new leader joins the organization. The CAE must be alert to this possibility, as the rest of the organization will often mimic new leadership, and formerly unacceptable behavior may become acceptable. Concerns about leadership changes should be discussed with the chair of the audit committee or similar function. “CEO Expenses: Personal or Business?” on page 43 illustrates how significant cultural change can lead to political pressure.

In some instances, organizational culture's influence on political pressure

may be much less overt. An “invisible hand” of pressure may guide employees' behavior—whether they realize it or not. For example, the culture may subtly discourage challenges to authority or even open inquiry. CAEs need to consider whether such acculturation could be affecting them personally, or their staff, and explicitly communicate with staff their expectations for independence, objectivity, and integrity.

The CAE also needs to understand, in advance, whether the organizational culture is a good match for his or her personal values. Participants from the IIARF study encouraged discussion with board members and executives regarding their values and their expectations for the audit function. This is best done when interviewing for a CAE position, to ensure compatible expectations.

A STRONG FOUNDATION

To position internal audit for success, CAEs need a strong, approved charter with a clear mission and mandate, appropriate authorities, unrestricted scope, sufficient resources, and an



**TO COMMENT
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When asked what **factors** help most with political issues, nearly **one-third** of CAEs said having an audit committee that is knowledgeable about the audit function, according to *The Politics of Internal Auditing*.

independent reporting line. The charter should be reviewed with management and the audit committee, and should document internal audit's unique and valued role, authority, scope, and reporting relationships, as well as executive and board expectations.

The CAE's status also plays an important role in minimizing political pressure and establishing a foundation of support for the audit function. The right level of organizational clout is necessary to stave off political risks and lend authority to audit findings. It is hard to imagine a CAE standing up to an executive vice president on an issue when the CAE reports administratively to a mid-level manager and rarely has access to the audit committee or the executive suite.

SOUND JUDGMENT

Sound business judgment builds respect for the internal audit function. The CAE must decide which battles to fight and be able to determine the difference between major and minor issues. Raising

BOARD AND AUDIT COMMITTEE EFFECTIVENESS

Independent and effective boards and audit committees are crucial to managing political pressure. In some situations, however, board members empathize with managers whose backgrounds are similar to their own, deferring extensively to management while too readily dismissing the CAE's concerns. CAEs need to have a frank discussion with the board/audit committee and management, in advance, regarding approaches to responding to political pressure.


When a politically charged situation arises, the board/audit committee needs to be objective and knowledgeable about the risks to the organization. It also needs to understand the challenging role of internal audit and have sufficient experience and judgment to exercise its fiduciary role. The IIARF study found several examples of nonexistent or ineffective audit committees, particularly in areas such as governmental units or smaller businesses.

the advantages to everyone concerned. They lay the right groundwork so that management understands the risks that will be assessed, and that internal audit is working to find mutual areas of interest—such as managing risks to achieve objectives. As issues are identified, CAEs need to communicate timely, at the right level, and in the right way.

AN ORGANIZATIONAL CONSTANT

Due to the nature of organizations—and our basic human desire to succeed and be respected—political pressure will always exist. The good news is that a proactive approach can be implemented in most situations to mitigate political pressure effectively. The mitigating factors all start with a strong corporate culture that embraces clearly defined organizational governance and values, competence, and objective, fact-based discussions and decisions.

But the onus lies not just with the organization—internal audit must assess itself and determine whether its value proposition is understood by, and aligned with, that of its clients. Moreover, the CAE must build and staff a strong function that provides that value. The CAE needs to possess integrity and gain credibility and respect by understanding the business, building relationships, demonstrating objectivity and good judgment, and communicating tough issues fairly and thoughtfully.

Addressing political risk is not an easy task. But it is essential to the success—and even survival—of the internal audit function, and the organization it serves. 

Addressing political risk is essential to the success of the audit function.

minor points or overlooking significant but controversial issues—or choosing not to report them—opens the door to future pressure. “Executive Witch Hunt” on page 44 describes how one CAE used sound judgment to help withstand pressure from the organization's CEO.

Internal audit must also demonstrate effective judgment to determine the level of evidence needed to support conclusions. More substantive testing on large issues may be necessary to ensure auditors have sufficient facts and persuasive information. Issues need to be compelling, clear about implications and risks, and based on solid data.

COMMUNICATION SKILLS

The CAE and audit team must be sensitive and effective communicators when dealing with a politically charged situation. Awareness of who is, or may be, affected by the audit findings and an understanding of their viewpoints are essential to handling political pressure. Learning how to communicate well in negative situations can be the difference between success and failure.

The tone for an audit is set with the first communication management receives about the role and objectives of internal audit. Proactive CAEs explain why the audit will be performed and

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A Focus on People

Arthur Piper

“

If you are going to be a global player in today's workplace, you must embrace diversity in a big way,” Phyllis James, executive vice president, special counsel for litigation and chief diversity officer for MGM Resorts International, the global hospitality business, says. And the organization has done just that—winning a raft of awards, including top ranking places for its diversity and inclusion activities from the Women's Business Enterprise National Council, *Hispanic Business* magazine, *Black Enterprise* magazine, and the Association of Diversity Councils, to name just a few. James is the first

to point out that reaching this pinnacle—and working to sustain this level of achievement—has involved hard work, money, and a huge commitment from top management downward.

The benefits of these efforts are also evident in the transformation of MGM's internal audit department. Today, with a staff of 82 people, the internal audit department employs geography, technology, and mathematics majors, and people with construction and architectural backgrounds, among others, to better reflect the organization's activities. Moreover, Bob Rudloff, MGM's senior vice president of internal audit, has become one of the

biggest champions of diversity initiatives in the organization.

A BUSINESS IMPERATIVE

In 2000, Terry Lanni, the late chair of then MGM Mirage, was the first to recognize the need for the company to establish a formal diversity policy. That year, he spearheaded the company's diversity and inclusion initiative, which was given impetus during the development of a resort in Detroit. Lanni realized that if MGM was to successfully expand into other parts of the U.S. and further abroad, the company would have to embrace greater diversity across the board—in terms of employees, business partners, and customers. The company launched a massive communications and training initiative, called the Diversity Champion Workshop, to explain why diversity and inclusion is so important to the business—a program that still exists.

"We have an operating principle that everybody who is a manager—from the chairman down to the first level of management—must complete this workshop," James says. Initially, that meant pushing thousands of people through the program—no easy task. But while many organizations reach this point, Lanni went further by insisting that diversity and inclusion is treated like any other business initiative. That meant formal strategic planning, quarterly status reports, and establishing a designated diversity officer with a department to support the program.

"A lot of companies stumble because there is no muscle behind their beliefs," James says. By comparison, every business department at MGM Resorts International—from supplier and construction to human resources and public relations—is required to report annually to the board of directors about how they have integrated diversity and inclusion

into their businesses. Those results are directly linked to the compensation system for the management group.

NO OPTING OUT

Like most corporate initiatives, the diversity and inclusion program met with plenty of skepticism and apathy in the beginning. James says one of the biggest obstacles lay in persuading key influencers in the business that this was not just management's most recent flavor of the month. The answer was tough leadership. "Our chairman and entire board of directors took this up as a fundamental initiative and said, 'This is not negotiable by anyone in our company and no one gets to opt out,'" James says. "Leadership was extremely

important in anchoring this in our culture and our business operations."

The Supplier Diversity Program was introduced to help minority- and women-owned businesses become competitive providers of their products and services. "They were sitting there under our noses and we had just never looked at them before," James says. Pulling from a wider supplier base made the company more competitive, she says, and helped persuade managers that the diversity and inclusion program was there to help rather than hinder their work.

James also credits the program with being one of the key drivers to making the 2000 merger with Mirage Resorts and the 2005 US\$7.9 billion

DIVERSITY OF THOUGHT

"The real value of diversity in the global marketplace today is not just ethnicity, not just gender, but also the diversity of thought that allows a company to truly innovate," says Larry Harrington, vice president of internal audit at Raytheon, a global defense and security company, and champion of The IIA's Diversity & Inclusion initiative.

Traditionally, many professions—internal audit included—have tended to attract people of like minds, schooling, and backgrounds, he says. But the danger of this trend is twofold. First, it creates monocultures that are insular and conservative in the way that they think. Second, people from minority cultures feel invisible in such organizations and often leave because their views are not heard or acted on.

"It's no secret that internal audit has tended to predominantly attract people with financial and accountancy training," he says. "But if the profession is to have breakthrough thinking, it has to surround itself with people who don't all think in the same way."

Harrington says he is not a believer in reverse discrimination, promoting people purely on the basis of their race or gender to hit inclusion quota targets. However, Raytheon's internal audit department has enviable inclusion and diversity statistics. Half of the team are women and 25 percent are people of color—and there are similar proportions of people with these attributes in the internal audit leadership team.

Instead of using quotas, Harrington says he has recruited from non-typical places, such as the National Association of Black Accountants for financial staff, other parts of Raytheon for people with expert business knowledge, and to novel places to acquire the skills the internal audit function needs.

Companies that are more diverse in **race** and **gender** are 35% and 15%, respectively, more likely to have higher than average financial returns, according to a 2015 report from McKinsey & Co.

acquisition of Mandalay Resort Group work. Numerous studies have shown that such mergers look good on paper, but often fall apart because the separate cultures do not gel as a single entity.

The inclusion message became a unifying platform for the three very different organizations, James says. “The fundamental message of our diversity and inclusion initiative is mutual respect, regardless of race or ethnic origin, regardless of where you came from and what company you used to be with,” she says. “It has become a powerful, unifying force for understanding that we are a part of one whole company, that we are all dedicated to one mission—which is to provide world-class guest services to the people who

come to stay with us, or who entertain with us. That message has become embedded in our culture.”

DIVERSITY CHAMPIONS

The internal audit department is responsible for auditing the accuracy of the diversity data that the program generates and that is publicly reported. Given the prominence of the initiative within the organization, Rudloff says that when he first stepped into the role 12 years ago, the CEO emphasized audit’s role in challenging the data to ensure figures were correctly stated. But internal audit’s involvement with the program goes way beyond verifying data.

When Rudloff joined the internal audit function, it had a staff of



“A lot of companies stumble because there is no muscle behind their beliefs.”

Phyllis James



“We needed some diversity of thought on the team to bring us fresh ideas.”

Bob Rudloff

Before working at Raytheon, for example, Harrington worked as head of audit at a life and health insurer. He decided to hire two female nurses who knew the health industry from the inside. “People thought I was a bit crazy, but those nurses were able to give internal audit insight into things we’d never looked at before, to better improve process, streamline efficiencies, and reduce costs.”

He says when he reaches out to minority groups about what he is trying to achieve in the internal audit department and what Raytheon is trying to achieve, the message is generally well received. “I’m able to attract really high-quality people because they want to be part of an organization that has upward mobility, that will invest in them, and in which they’ll feel respected and included,” he says.

Raytheon’s diversity and inclusion efforts have won it accolades. In 2014, for example, the Women’s Business Enterprise National Council listed the business as one of the top corporations for supporting women’s business enterprises—specifically through its supply chain procurement. The same year, it ranked eighth in the top 50 U.S. organizations for providing multicultural business opportunities.

From 2010 to 2014, Harrington headed this initiative as Raytheon’s executive diversity champion. He credits his time in that post, during which he met thousands of people, with helping him build companywide trust for the internal audit department. It has not only helped him recruit from across the organization, but it has made people understand that Harrington and his team are on their side.

“If you truly have a brand that says ‘we’re here to help’—if they believe it, they are going to use more of your services,” he says. “And if when they use your services, you have such a diversity of people that you are truly able to relate to their way of doing things, think about things differently, and bring solutions to the table they never thought about, then they want more.”



24 people, all of whom had graduated from the same school and were accounting and finance majors. “There was nothing wrong with the school,” he says, “but we needed some diversity of thought on the team to bring us fresh ideas, so it was obvious we had to recruit more broadly.”

Rudloff says he wants to initiate a rotational program to bring people from other parts of the business onto the internal audit team. He has hired auditors who previously held positions in departments such as housekeeping or from the food and beverage division. He says that has helped his team get a grip with the real world experience of the organization and to deal with employees with more sensitivity. In addition, Rudloff has hired people whose first language is not English to help audit overseas operations.

“The makeup of my team now represents the employee work base and it allows us to engage better with our employees at all levels,” he says. “Sometimes it takes getting a conversation going in someone’s own language so they don’t feel threatened by us as the auditors coming in to deal with them.”

WALKING THE TALK

Two years ago, Rudloff made a personal challenge to members of his team to go through the organization’s Diversity Champion Workshop. This workshop is now seen as a rite of passage for all who become managers. But Rudloff wanted to go further, to encourage team members at all levels of seniority to participate.

“Audit team members interact with people in different parts of the business through the workshop and develop relationships that can last through their careers,” Rudloff says. “On the other side, people in the business develop relationships with internal auditors and see that we are not bad guys.”

“The workshop helped me to listen more to the organization and the business units, rather than just crunch the numbers or point out what’s wrong,” Yakima Brookins, director of internal audit at MGM Grand in Detroit, says. “I’ve created a regional brand that shows internal audit considers the objectives and challenges of each business unit when making its recommendations.”

She says that the workshops also made her reflect on her approach to leadership and the way she communicates within the business. “Often, what we’re relaying could be contentious to management,” she says. “My role has been to proactively consider potential objections and keep interactions positive as, ultimately, the goal is to present solutions in the best interests of the organization.”

Additionally, MGM Resorts International currently runs 15 different employee network groups. People of like minds, backgrounds, and interests communicate with each other and feed their concerns and ideas into the organization via these networks. Rudloff encourages his team to be active in these groups. In fact, he says, internal auditors hold more network leadership positions and offices than other departments in the organization. Rudloff chairs the interfaith group, for example, and Jerry Hancock, senior internal auditor at MGM Resorts, is actively involved in the Veterans and lesbian, gay, bisexual, and transgender (LGBT) employee network groups. Participation in the network groups has multiple benefits, including individual development, the opportunity to contribute to the business, and networking.

“My involvement with the company’s Veterans and LGBT employee network groups has quickly allowed me to expand my professional network while developing stronger relationships in the company,” Hancock says. “As I continue to build trust and expand my



My involvement with [the groups] has quickly allowed me to expand my professional network.”

Jerry Hancock



My role has been to proactively consider potential objections and decide to keep interactions positive.”

Yakima Brookins

Direct CEO involvement in diversity initiatives and supplier diversity are common themes in DiversityInc.'s 2015 Top 50 list of diverse companies.

network, I gain greater influence, which provides more opportunities to contribute value to the company.”

Hancock says that the company's diversity training made him reflect on the business' motto, “You don't have to be one of to stand with,” which means that you do not have to belong to a particular demographic to support equality.


“During the two-day Diversity Champion workshop, we did an emotionally charged activity that underscored that fact,” he recalls. “It involved identifying harmful stereotypes and associating them with actual people in the room. The objective was to show the tremendous power that words can have while reinforcing the idea that, when united, people can make a difference.”

He says this experience has made him think more about the stereotypes that people may have about internal audit—such as seeing them as the company police. That has made him strive to conduct himself in ways that aim to change other peoples' perceptions of his audit work and of the internal audit profession.

Audit staff members also are involved in the broader enterprises under the organization's corporate social responsibility initiative, including environmental sustainability and community engagement. “When they go out to our different business units to audit, they are now naturally seeing things from a sustainability standpoint, for example,” Rudloff says. “They often have very untypical internal audit input into what they see going

on in our business. It's created a mindset beyond the narrow scope of what internal auditors do, which is of great benefit to the business.”

A BROADER VISION

This broader view, the creation and acceptance of diverse and unexpected viewpoints, is the real goal of MGM's diversity and inclusion initiative. As Lanni realized in 2000, the company's future success depended on its ability to innovate and empathize in equal measure. To be a 21st century company in a global market requires the wide-ranging, inclusive outlook that diversity enables. 

ARTHUR PIPER is a writer who specializes in corporate governance, internal audit, risk management, and technology.

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s I begin my term as the 2015-2016 chairman of The IIA's North American Board, it doesn't seem possible that it has been 32 years since I completed my first internal audit. It was a different world back then. I started my career at a time when all workpapers were completed manually on narrative sheets and columnar pads – red pencil for tic marks, blue pencil for review notes – and audit report drafts were handwritten and left with the audit client's management until they could be typed by the steno pool back at the office. There was no email, no Google, and facsimile machines were the epitome of high tech.

Although the technology we use to complete our work today has changed dramatically, the foundational skills and attributes of a good internal auditor remain the same: inquisitiveness, persistence, problem solving and analytical ability, interpersonal communications, professional objectivity, and a genuine desire to influence positive change in an entity's operating and control environment. In retrospect, I consider myself fortunate to have started in an entry-level internal audit position with JCPenney Co., an organization that had a long history of supporting and developing a world-class internal audit function. As I moved through the company's

make YOUR MARK

Photographs by Alyssa Schukar

The new chairman of The IIA's North American Board, **MIKE JOYCE**, says now is the time for internal auditors to step up, be recognized, and have an impact.



Pittsburgh, Philadelphia, and Dallas offices, I realized there was a lot to learn, and I was surrounded by knowledgeable, experienced people who were willing to teach me.

Today, as I look to build on the outstanding leadership and vision of my predecessors in the North American chairman's role, I hope to share what I've learned over the years and help internal auditors throughout North America maximize their potential. My theme for the year, "Make Your Mark," recognizes that internal auditors have a responsibility, and are uniquely positioned, to make their mark in three primary areas: their organizations, their profession, and their communities.

IN THE ORGANIZATION

I have been the chief auditor and compliance officer for Blue Cross Blue Shield Association (BCBSA) since 1999. BCBSA is a national federation of 37 independent, community-based and locally operated companies that collectively provide health-care coverage for nearly 105 million members — one

in three Americans. My role encompasses several diverse responsibilities. The scope of my internal audit work includes all activities within our Chicago and Washington, D.C. offices. As the compliance officer, I administer our internal employee code of conduct, business ethics training, conflict of interest process, and compliance hotline. In addition, I am responsible for our national anti-fraud department, which provides support to each of the 37 independent BCBSA Special Investigation Units (SIUs) that fight health-care fraud through prevention, detection, and investigation activities. Fortunately, BCBSA also has a long history of promoting a strong control environment and a senior management team that actively supports our internal audit and compliance activities.

In my career, I have observed that those departments that seek to build collaborative relationships with management have the most consistently positive impact on their organizations. For example, we continually identify and foster those relationships that help



“The most **impactful audit observations** often result directly from employees who, based on the rapport and trust previously established by the internal auditor, volunteer information.”

facilitate review and mitigation of key risks, including those with the finance, IT, human resources, and legal departments. Periodic lunches or meetings with relevant personnel, when there is no specific audit to discuss, go a long way toward establishing long-term rapport. We are unique given the dual accountabilities we have for internal audit and our internal ethics/compliance program. We must be careful to acknowledge and work to lessen the possible blurring of identity between the second and third lines of defense, as well as ensure that our Finance & Audit Committee is comfortable with the objectivity that has been established. I have often spoken about the merits of audit functions building

strong relationships with their compliance functions if they are separately organized, as there is a strong mutual benefit to working together to identify risk management opportunities.

That collaborative approach will not be successful, however, without a deliberate and continuous effort to establish the audit function's credibility, objectivity, and integrity and a mutual focus on the success of the organization. Industry knowledge can be acquired through specialized training and on-the-job experience, but auditors who are respected within their organizations also seek to contribute in other ways. For instance, volunteering for special corporate task forces, employee social

events, or charitable initiatives allows the auditor to interact with employees in a nontraditional, nonthreatening environment. The most impactful audit observations often result directly from employees who, based on the rapport and trust previously established by the internal auditor, volunteer information.

Establishing strong rapport and visibility with the audit committee and senior management, as well as reinforcing the professional and standards-driven orientation of the internal audit function, help foster a corporate culture where internal audit is respected and has earned a seat at the table. The ability to proactively identify and prioritize corporate risks, maximize finite audit resources through efficient and innovative audit techniques, and develop value-added recommendations for enhancing operations to help management achieve its objectives are tangible metrics internal auditors can demonstrate to make their mark within their organization. At BCBSA, we build an annual plan as a guide for addressing identified risks; however, we continually adjust that plan as necessary to react to

THE IIA NORTH AMERICAN BOARD

The North American Board is charged with overseeing all IIA operations in the U.S., Canada, and Caribbean through providing strategic direction and guidance to Institute staff. These responsibilities include establishing membership rates and approving annual budgets; approving new chapter formations/chapter dissolutions; providing for an extensive volunteer structure to support local, regional, and national IIA activities and training programs; and establishing reporting and control requirements to promote consistency among chapter volunteer leadership.

Early in 2015, the North American Board went through an intensive strategic planning session to ensure that its core purpose and 2015-2020 strategic goals were appropriately aligned with the revised IIA Global Strategic Plan, while focused on the unique needs of the North American membership. In fact, the refinement of our core purpose – to advance the internal audit profession and serve our members – reiterates the Board's commitment to ensuring that all of our efforts continually provide value to our chapters and our members. The four North American goals that were crafted – Professionalism, Advocacy, Sustainable Value, and IIA as Leader – are being finalized with specific tasks and expected outcomes that members should be seeing and experiencing as part of our messaging and communication outreach efforts over the next several years.



new or emerging risks. Most of these new risks come to us in the form of management requests, which is a good validation that management perceives value from the services we deliver.

IN THE PROFESSION

I believe one should fully engage in one's profession, whether it's a lifetime commitment or a transitional role. The concept of transitional or rotational auditors continues to evolve. There can be a real mutual benefit to dropping a high-potential employee, or an individual with specialized skills, into an audit function for a limited time. However, those individuals still must understand and internalize the basic tenets of the profession — integrity, objectivity,

and technical competence. To a great extent, credibility comes from current knowledge and command of the basic skills that define a profession. All internal auditors can make their mark within the profession by embracing and promoting The IIA's International Professional Practices Framework.

As the expectations of the profession increase and evolve, we should acknowledge our skill gaps and seek out experts to help fill in the blanks. We can join like-minded groups to network and bounce ideas off peers who are experiencing many of the same challenges, regardless of industry or organization. Mentoring is a great way for staff to integrate themselves quickly into an organization, and in turn accelerate their ability to make valuable contributions within those unique organizational cultures. Similarly, networking has proven to be a very efficient way to borrow or adapt specific audit approaches and techniques from others who are willing to share. We can make our mark by training and mentoring others, as we were once coached and helped by the leaders before us.



**TO COMMENT
on this article,
EMAIL the
author at mike.joyce@theiia.org**



"CHICAGO IS A GREAT CITY, and it has been my home for 20 years. However, I will always be a proud native of Pittsburgh and a lifelong Steelers fan. I also have a passion for music. While working both in Dallas and Chicago, I performed in bands with my



“We can serve as **role models** and representatives of the **internal audit profession** and make our mark by sharing our skills, talents, and enthusiasm in a variety of ways.”

Becoming involved with The IIA is obviously a great opportunity for internal auditors to get more invested in the profession. I was encouraged to volunteer for the IIA–Dallas Chapter shortly after becoming an IIA Audit Group member in 1989. That first committee assignment has led to an almost unbroken string of committee, officer, and local board roles. I served as the Chicago Chapter president in 2001–2002. I also have served on various international and North American committees and assignments since 2003. The friends I have made along the way continue to be valued resources and mentors. I encourage all members to make their mark through becoming involved with their local IIA activities and helping grow the next generation of audit leaders.

The IIA’s long-standing motto, “Progress Through Sharing,” is achieved when we realize that what we put into a volunteer role comes back to us manyfold in the form of resources, friends, and the support of a network of experts. Often overlooked, however, is the benefit to our own skills when we achieve results in a volunteer role through

persuasion, organizational acumen, and the ability to complete tasks through peer motivation, rather than through designated management authority.


IN THE COMMUNITY

It is important that internal auditors also make their mark in their communities, as this helps expand the reach and awareness of the profession. Whether through activities for our children, or through our own favorite hobbies or civic causes, we can serve as role models and representatives of the internal audit profession and make our mark by sharing our skills, talents, and enthusiasm in a variety of ways. For many people we encounter, it may be the first time they have ever met or come to personally know an internal auditor, so we need to make those connections count.


Internal auditors have many skills that would be extremely useful in a variety of local community volunteer or charitable groups. Through their financial acumen, ability to suggest reasonable controls, or strategic business sense, internal auditors can help community organizations achieve their objectives

more effectively. Internal auditors can give back in many ways. Serving as the treasurer of a private school board taught me more quickly about internal politics, especially when it came to raising tuition rates, than years in a corporate environment alone ever could. These outside activities can help to better prepare us for our corporate roles.

THE YEAR AHEAD

In my year as chairman of the North American Board, I plan to work closely with IIA staff, chapter leaders, and individual members to ensure that we are making our mark in the services that we provide. I intend to continue to advocate for the great work and critical role of internal audit professionals. I plan to fully engage our volunteers in helping to implement the new North American Strategic Plan and will work to help our members realize their full potential and make their mark. 

MIKE JOYCE, CIA, CRMA, CPA, is the chief auditor and compliance officer at Blue Cross Blue Shield Association based in Chicago.



fellow internal auditors and played in a variety of local venues. Drumming and playing guitar with staff members who are talented auditors and musicians has enabled all of us to fully embrace the ‘auditor as rock star’ mantra, if only for a few hours at a time!”



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Strategic Alignment

Jason Pett

Today's business environment is unfamiliar terrain for many. Companies are expanding into new markets, making acquisitions, forming joint ventures, radically innovating their product and service portfolios, and entering new sectors. In total, nearly 70 percent of companies have gone through, or are going through, a business transformation in response to market shifts, according to PricewaterhouseCoopers' (PwC's) 2015 State of the Internal Audit Profession study. Another 12 percent anticipate doing so in the next 18 to 24 months. With such dramatic business transformation underway, companies inherently face new and more complex risks.

In periods of transformation, it is critical for the internal audit function to remain relevant and risk focused by concentrating on the right risks at the optimal time in the

Internal audit functions can follow four steps toward greater involvement in strategic initiatives.

STRATEGIC ALIGNMENT

process. Internal audit can execute against that mandate through proactive involvement in strategic initiatives.

SETTING ITSELF APART

At those organizations where senior management and the board see internal audit departments as contributing significant value to their companies, internal audit is more often involved in the most important business initiatives. In fact, according to the PwC report, these internal audit functions are involved in transformational initiatives up to twice as frequently as their peers. Among those functions viewed as contributing significant value to the business, many are involved in key areas, ranging from the implementation of new privacy and security strategies, to cost-reduction initiatives and new product and service development.

There is a clear correlation between stakeholder perception of value and proactive involvement from internal audit on strategic initiatives. As such, nearly half of highly valued internal audit functions are providing that proactive perspective compared to 19 percent of less-valued internal audit functions.

This does not mean that internal audit is providing input on what the strategic initiatives should be. Rather, internal audit is proactive in providing input on risks related to critical company initiatives and in advising on processes, governance, and controls ahead of the risks' occurrences.

Areas in which more than half of highly valued functions are “ahead of the risk” (or providing a proactive perspective on risks that arise from strategic initiatives) include innovation, marketing and sales strategies, increases in risk management and compliance investments, changes in technology, geographic expansion, and even the overall business model, itself. The same correlation is evident at the

other end of the value spectrum, with those functions not adding as much value more often involved reactively in initiatives — by auditing processes and controls after risk occurrence.

Through close involvement, internal audit has a constant presence within the business.

PROACTIVE INVOLVEMENT

As leading internal audit functions align more closely with the strategic direction of the company and provide proactive perspectives on risk, stakeholders quickly realize that the value internal audit brings is measured by the risks that are identified, discussed, and effectively mitigated or accepted while moving the organization forward — or by the speed at which decisions can be made with a more holistic understanding of risk — rather than the number of audit reports issued or findings identified.

Proactive advice can present in many forms. Through close involvement, internal audit has a constant presence within the business. If an audit plan is in place, it should be flexible and constantly evolving, depending on the risks facing the organization. Advice doesn't necessarily have to emerge in the form of an audit, and communication doesn't necessarily have to appear in a traditional audit report. Highly valued internal audit functions are consistently taking four steps to ensure their involvement:

- 1 Participating regularly in strategic planning discussions with company executives to keep internal audit's efforts aligned with the direction of the business and to prompt pertinent risk discussions



**TO COMMENT
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Strategic-level risks are expected to account for only 17% of 2015 audit plans, according to respondents of The IIA's Pulse of the Profession report.

STRATEGICALLY ALIGNED AUDIT FUNCTIONS

Internal audit functions are innovating and aligning with critical business strategies in diverse ways. Departments are adapting to the changing risk environment to remain valuable contributors to the business.

» At a financial institution, involvement in strategic initiatives goes hand-in-hand with working across lines of defense. Internal audit meets regularly with risk management, compliance, and other second-line-of-defense leaders to discuss work being performed, synergies that may be accomplished, and where they can better align. In collaboration with enterprise risk management (ERM), internal audit follows the ERM framework and assesses emerging risks for the organization. As ERM identifies risks, internal audit is part of the evaluation process and can provide input about other potential emerging or key risks to the organization.

» At a financial services company, internal audit has purview over all key initiatives but is not actively involved in every one of them. Internal audit rates the risks associated with initiatives and engages more deeply in those with the highest residual risk. Internal audit reviews project plans and milestones, reports to management and the audit committee, and provides an independent perspective on the status of the key initiatives and the risk profile as they progress.

» One health industries organization is significantly increasing its use of outsourcing to third parties for cost management and progressively entering into growth-focused joint initiatives. As those programs launch, internal audit becomes engaged early in each process. For example, because intellectual property is shared between companies in the joint initiatives, internal audit assesses the third party's processes and controls for their levels of data security and privacy. As the number of such programs increases, internal audit reallocates its resources and shifts its skill sets to monitor the new risks associated with those relationships.

» Internal audit's involvement in major initiatives at a retail and consumer organization starts with meeting with the strategic initiative owners and facilitating working sessions focused on possible new risks embedded in each initiative. The focus in these sessions is on identifying risks that could significantly affect the company and on defining specific mitigating strategies. Once the business has determined the metrics that will define both the success of the initiative and the management of the risks, the metrics get evaluated by internal audit and then monitored quarterly.

» Proactive involvement depends on internal audit's awareness of initiatives and engagement with stakeholders. To accomplish that, the internal audit function of one technology company follows a matrix organization structure with resources aligned by product and business process. That specialty enables the internal audit team leads to foster deep relationships with the product teams, keep active vigilance on the business, and more effectively understand and identify new and emerging risks.

STRATEGIC ALIGNMENT

early on. Organizational goals are actively changing, and regular participation in strategic planning discussions helps internal audit provide proactive guidance on new initiatives, as well as plan how it will deliver future value to the organization.

2 Aligning internal audit teams the way the business is structured to gain a better understanding of the business and foster deeper relationships within the organization. Internal audit may be aligned to business segments or to functional groups, or, in some organizations, have a matrixed organization where auditors align to both a line of business and a functional

unit. As a consistent point of contact for the business, auditors build relationships and establish an open communication channel through which they build business acumen and provide advice on risks on an ongoing versus periodic basis.

3 Harmonizing more closely with other risk and compliance management functions to ensure one common focus on risk, particularly risks related to the strategic direction of the company. Better alignment can result in less risk management fatigue among participants — reducing the potential for having the same groups audited repeatedly. It can also

result in enhanced efficiency — the lines of defense have better visibility into the information produced by the other lines, and as a result are better able to leverage their work.

4 Building stakeholder support from the top. Internal audit's involvement in strategic initiatives is driven by support from chief executives and the audit committee, arising from the consistent value derived from internal audit's involvement. Value delivery results in stakeholder support, which results in even greater opportunity to deliver value. To initiate this cycle, internal audit looks for opportunities to go



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Internal audit needs to develop the capability to continuously align or realign audit coverage to address emerging risks, according to The IIA's Pulse of the Profession report.

above expectations and engage with the business in innovative new ways. When internal audit and its stakeholders work together to determine how and where internal audit should be contributing, it can result in not only better alignment to the overall business objectives and direction, but also efficiency and greater value derived from internal audit deliverables.

THE RIGHT TALENT

It is clear that to consistently add value and execute on the strategy of aligning the internal audit function to the business and to the business's strategic initiatives, the function must comprise resources with deep business acumen

and both industry and technical skills. Without a foundation built on the right talent, the function is limited to executing only up to its existing capabilities — not striving to deliver the value it should. Top performing talent enables internal audit to focus on the risks associated with the strategic direction of the business so it is sought out as a major participant in the business' strategic initiatives.

BUILD A ROADMAP

Even though most internal audit functions have identified the need to evolve their departments in some way — by managing new risks, adding new skills, collaborating with other risk functions, and applying technology — few have a plan in place to attain those objectives.

Without such a plan, it's difficult to stay clear on internal audit's vision and mission and take the necessary steps to evolve the function. Internal audit should begin with a roadmap.

Internal audit can move toward more proactive involvement in strategic initiatives today. Concurrently, it can initiate a strategic planning process that advances its capabilities in alignment with broader business imperatives. Internal audit then has a roadmap from which it can develop talent, drive better alignment, invest in technology, and deliver even greater value. [\[e\]](#)

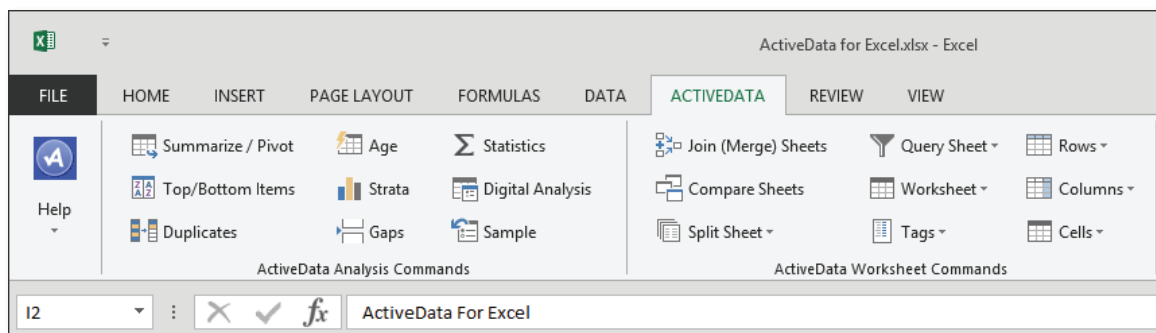
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Governance Perspectives

BY THERESA M. GRAFENSTINE EDITED BY MARK BRINKLEY

THE PROACTIVE RISK ADVISER

Internal audit needs to move away from its retrospective focus on assessing risks.

In the early days of my career, I was given the opportunity to lead an entrance conference to kick off an audit. It was on that day that I met my first U.S. Air Force general. After I enthusiastically went through my slides, the general said to me, “Do you know who you auditors are? You’re the ones who come in after the battle to bayonet the wounded.” As a young auditor, I felt crushed. I did not see my profession or myself that way. I was truly there to help improve things. Now, after having been an internal auditor for more than 23 years, I look back and think that the general may have gotten it, partially, right.

Traditional audits tend to be retrospective. Internal auditors come in six months or a year after a project (battle) has ended—after the tough decisions have been made and the hard work completed—and second-guess (bayonet) management (the walking wounded) all

with the benefit of 20/20 hindsight. Aside from the resentment and distrust this breeds with management, we need to ask ourselves whether retrospective auditing really improves our organizations.

Internal audit needs to shift from a retrospective audit/compliance focus to proactively assessing emerging risks to remain relevant and provide value to our organizations. Although retrospective auditing has an important role in helping ensure that controls are working, some of the biggest threats to our organizations are those we have not seen before or are very complicated and push us out of our comfort zones. When we limit ourselves to retrospective, compliance-based audits, we underestimate the value we could provide our organizations. Moreover, with risks increasingly associated with large, customer-facing system implementations, complex regulatory environments, and cybersecurity, we are ignoring

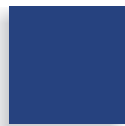
the most significant risks our organizations face.

It is in our nature as internal auditors to want to ensure that what we audit is in compliance with applicable rules and regulations. However, we need to avoid the trap of blindly enforcing flawed rules. We need to ask whether the rule makes sense.

The 2008 mortgage crisis serves as a compelling example of “compliance myopia.” Using a compliance-based checklist, even the most byzantine of mortgage products that were available in 2008 would likely have passed an audit or regulatory review of the loan package. The form was correctly filled out for the sub-prime loan—check! However, the checklist did not have a box that asked whether this was a seriously flawed loan product that would ultimately pose an existential threat to those companies offering it.

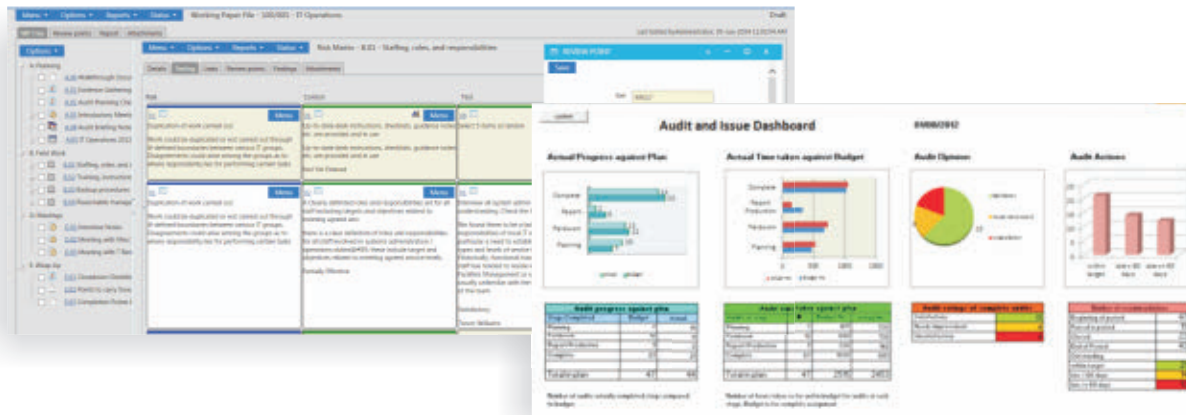
This is not to say auditors should stop enforcing

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regulatory requirements or other rules. We should use our role as a bully pulpit to get tragically flawed rules corrected and not wait until our organization — or global economy — is brought to the brink of disaster. Internal audit needs to move from a pure compliance focus to a strategic, risk-based focus.

No organization has ever gone out of business because it failed a timecard audit — but what about a major cyber hack and loss of intellectual property, a database breach that

audit has limited value, contributes to escalating project costs, and damages internal audit's credibility.

Even if we can all agree that proactive, risk-based auditing does not affect our independence, we may not have the kind of relationship with management and with our audit committee that they would welcome our involvement. Building the right relationships requires consistent and high-quality products; candid, professional, and frequent meetings; and a highly trained and diversely skilled staff. Unless we work at developing relationships with key stakeholders, they will not trust us enough to invite us in while they are trying to meet deadlines and make decisions with imperfect data. The objective is for management to see the internal auditor as a proactive risk adviser who will provide added assurance that management has considered a wider variety

of risks than they would have alone.

When we start adding the largest threats to our audit plan, it can feel a bit overwhelming. The trick is prioritization. Auditors should talk with management, the board, and the audit committee and develop a collective understanding of the risks the organization faces. This will provide a basis to prioritize resources and audit those things that present the highest level of risk. If that leads to an area not addressed before, such as cybersecurity, the auditor will have to make a “build vs. buy” decision. Does the CAE have the requisite skills on staff that, with some training, will be able to use available industry best practices to assess cyber vulnerabilities? If not, the CAE will have to buy those skills by hiring outside resources. Although contracted resources can initially be expensive, avoiding existential risks, like cybersecurity, is not an option. For starters, the CAE should build into contracts the requirement that the outside experts train the audit staff. The goal should be to cultivate those skills within the audit organization so that there is a sustainable model to address these risks in the future.

The Bottom Line: Internal auditors are positioned to see across an organization, to understand overarching risks. Unlike external auditors, we have the benefit of understanding the corporate culture and internal business practices. Internal audit needs to step up and be the proactive risk adviser that our organizations desperately need. By being proactive and looking at issues of strategic importance, auditors can strengthen the organization and help navigate the risks in an increasingly complex and dangerous world. [16](#)

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We must get ahead of these risks, identify vulnerabilities, and make recommendations to address them.

compromises customers' personally identifiable information (PII), or a multimillion-dollar system implementation failure? Yet, in The IIA's 2015 Pulse of Internal Audit survey, only 6 percent of respondents indicate they included assessing strategic business risk in their audit plans. If we wait until six months or a year after strategic risks have occurred, it may be too late for audit, because our organization may no longer exist. We need to get ahead of these risks, identify vulnerabilities, and make recommendations to address them before they are exploited.

So what is stopping us? We are. Internal auditors fail to create timely, proactive, risk-centric, service-oriented audits by misinterpreting independence and lacking strong relationships with management and the audit committee.

Maintaining our independence is crucial if we are to provide unbiased recommendations. Although we should never make management decisions, this does not prevent us from providing proactive, risk-based recommendations. Consider the example of most major system implementations. They can be very costly (e.g., system integrators, software, and hardware), customer-facing, pose security risks if not correctly configured, and damage our organization's reputation and credibility if not correctly deployed. We don't have to wait until after the system has been deployed to assess whether 1) the project team has mapped the system design to regulatory and functional requirements; 2) basic project management practices are in place and include provisions for robust testing; 3) contract terms are being met; 4) internal controls have been considered; and 5) people who will handle PII have undergone background checks. These are the activities that auditors do well, and they do not violate our independence. Waiting until after the project crashes to swoop in and do an

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BY J. MICHAEL JACKA

WRITE YOUR OWN STINKING PROCEDURES

When clients ask us to do their procedural work, it is a sign that they have not embraced ownership of controls.

During a session at this year's IIA General Audit Management conference, an audience member asked for advice. His internal audit group had reported that the company's accounting controls could be strengthened by developing written procedures. The accounting department's response? "We don't have the time; you write them for us."

I'm sure every red-blooded auditor reading this reacted just as the crowd did—with shock, horror, and the phrase "we don't do original work" bursting from their lips. I was right there with everyone else.


Much later, I looked back on the chum-filled feeding frenzy and realized we had spent a lot of time focusing on the wrong issue. Impassioned discussions about internal audit's independence, objectivity, and integrity may make us feel good, but most of our clients believe these are nothing more than buzzwords that serve as an excuse to find problems without being part of the solution.

When someone asks us why we can't write

procedures for them, it speaks to the far too common misconception that controls are internal audit's job. It shows that the client has not embraced ownership of controls and the related control structure. And it reminds us we have the never-ending task of explaining to our clients that internal audit is not responsible for controls. For that matter, it is not the job of executive management, risk management, compliance, the Sarbanes-Oxley team, purchasing, marketing, janitorial services, or even a department that happens to be named The Place Where All Procedures Get Written.

The message that should be delivered to any department wanting someone else to write its procedures—to effectively outsource responsibility for controls—is that they may as well let someone else take over their area. By abdicating control over controls, they are effectively saying that all processes can be turned over to someone else. And that means there is no longer any need for the department.

And as a side note, it's important to keep in mind how the solution to this issue became evident—by stepping back from the client's argument about writing procedures and reframing it in a way that addresses the root problem. The issue is not that internal audit should not be writing procedures; it is that clients should own their own controls. Any time auditors find themselves in a losing argument, they should take a breath, step back, and make sure they are not arguing about the wrong problem.

So the next time someone asks why internal audit can't write procedures for them, remember that they are not questioning internal audit or even the need for controls. They probably just don't understand what ownership of controls really means. And that is a problem we should be able to help them with. 

J. MICHAEL JACKA, CIA, CPCU, CFE, CPA, is cofounder and chief creative pilot for Flying Pig Audit, Consulting, and Training Services in Phoenix.

READ MIKE JACKA'S BLOG visit InternalAuditor.org/mike-jacka

THE ETHICAL ENVIRONMENT

The issues internal auditors should assess around ethics in the workplace are numerous and complex.



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EY



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What are the most common ethical dilemmas organizations face today?

CHRISTENSEN An often encountered dilemma is the consideration of conflicting performance metrics around cost and time, on the one hand, and safety and quality, on the other. This ethical conflict can manifest itself in many ways—deferral of scheduled maintenance, outsourcing to low-cost/low-quality suppliers, shortcutting on quality standards, unbalanced reward systems, and blind obedience to authority, leading to conflict avoidance and group think. It is ironic that those at the top often are quick to blame those who are on the firing line making the critical decisions, even though the leaders have primary responsibility for the very culture that drives the pressure points incentivizing inappropriate decisions.

O'LEARY As the global business landscape becomes more complex, companies are facing a more diverse array of ethical dilemmas, even compared to just five or six years ago. Traditional ethical issues around bribery, corruption, money laundering, human resource matters, inappropriate financial reporting, or earnings management continue to exist and clearly need important education, awareness, monitoring, and prevention investments from organizations—especially given increased regulatory scrutiny. However, with the rapid investment and growth many organizations are focused on in emerging markets well beyond just Brazil, Russia, India, and China, added complexity permeates ethical considerations. Additionally, the continued expansion of the digital agenda across organizations, sectors, and markets adds a complex

array of issues to contend with, including cybersecurity, data privacy, and social media.

What impact do generational attitudes and cultural standards have on expectations of an ethical environment?

O'LEARY Generational attitudes and cultural standards can have a significant impact on expectations around ethics in an organization. As acceptable or common cultural and business practices can vary across diverse populations, it is important that organizations recognize this variability when strategizing around education, awareness, company policy, monitoring, and prevention techniques. For example, millennials' attitudes and expectations around social media introduce much greater complexity to how organizations handle the possible unintended or purposeful consequences that

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may be associated with information that is released into the cyber world.

CHRISTENSEN Generational attitudes and different cultures have a huge impact on sustaining an ethical environment because each generation and culture may have to be approached differently to achieve executive management's objectives. For example, because every generation was raised in a different environment, each has different attitudes, behaviors, expectations, and motivational touch points. Likewise, different countries and regions have distinctly different cultures, as do different organizations that merge. It is imperative to understand generational and cultural differences when communicating with employees in diverse organizations.

What are best practices for promoting ethical behavior within an organization? What is the best approach to ethics training?

CHRISTENSEN Promoting ethical behavior in an organization begins with an effective code of ethics linked to the organization's code for effective corporate governance. A code of conduct should be communicated, reinforced, and integrated into how executive management "walks the talk." With respect to ethics training, it is important that everyone participates, including executive management, and that the training is real, meaning it focuses on ethical dilemmas that are relevant to the organization and is tightly linked to its core values.

O'LEARY Best practice is to start with a well communicated tone from the very top. When the CEO, board, or other executives actively and routinely promote the company's values, culture, and ethical policies, it goes a long way in helping everyone consistently align with expectations. From there it's all about discipline and detail in having well-orchestrated communications, change management practices, and training programs that are embedded within the business or function for each employee. When companies help employees recognize that the ethical standards are not only important for compliance but also for the success of the organization's business imperatives and personal advancement, it has a much more profound impact.

What is internal audit's role in ensuring an ethical work environment?

O'LEARY Internal audit can play many roles helping companies ensure an ethical work environment. Certainly, traditional audit activities to monitor compliance continue to be relevant. Additionally, leveraging the power of data analytics and other innovative strategies helps add vigor

and real-time relevance to those efforts. But going beyond pure assurance or compliance auditing, internal audit can help companies assess the alignment of their ethics programs and evaluate the metrics companies have in place to measure effectiveness and whether those metrics help promote ethical behavior.

CHRISTENSEN Internal audit can play a key role in ensuring an ethical work environment. Internal audit should, for example, focus on the control environment and culture, look for the warning signs of dysfunctional behavior, and watch for incongruities between the tone at the top and tone in the middle. Internal audit should ensure that employee working conditions, both internally and upstream with key suppliers, are fair, safe, and free of human rights abuses, and that discriminatory hiring practices are avoided. The auditors should evaluate the balancing of costs of preventive maintenance, work shifts, safety controls, and training with the health and safety interests of employees. Finally, they should ensure an open, transparent environment that provides upward communication to people who listen.

What should internal auditors assess when looking at a whistleblower program?

CHRISTENSEN Internal auditors should evaluate the organization's risks, culture, management operating style, internal resources, and existing procedures regarding reporting of audit and accounting irregularities and fraud when assessing the design effectiveness of the program. In other words, the auditors need to understand the unique risks relating to fraud within the organization, industry, and geographies in which the company operates. Additionally, internal audit should ensure the program is communicated effectively and often within the organization; ascertain whether the appropriate level of objectivity is emphasized with respect to the reporting and investigation of complaints; ensure that laws and regulations for protecting whistleblowers are being addressed (e.g., Sarbanes-Oxley and Dodd-Frank in the U.S.); and understand and consider the implications of the U.S. Federal Sentencing Guidelines.

O'LEARY Internal auditors should assess the rigor of the program, technology enablement, and alignment to the sector- and geography-specific risk and compliance considerations the organization faces. Additionally, internal audit functions can help companies consider whether the whistleblower program is effectively communicated and whether awareness campaigns, education, training, and policies are fully aligned to enable the program to be optimally relevant. [la](#)



BY MOHAMAD REEDUAN MUSTAPHA

A MATTER OF VALUE

Internal auditors can take several steps to change negative perceptions and demonstrate their expertise.

Many of our clients maintain an unfortunate view of the internal audit profession. Rather than seeing it as a source of support and valued expertise, they consider internal audit a compulsory activity focused primarily on finding errors. They often don't recognize the critical role internal audits play or how they serve to help improve organizational performance. Practitioners bear the responsibility for these misconceptions, and it is our job to correct them. To change people's views, we must demonstrate our value.

Most importantly, perhaps, internal auditors must show clients that they possess the ability to make meaningful contributions to the business. Beyond our risk, compliance, and control expertise, we need to demonstrate a commitment to enhancing the organization with skills aimed specifically at improvement. Internal audit could supplement its existing competencies, for example, with business-specific acumen such as Lean Six Sigma. Many businesses today are implementing Lean thinking for efficiency,

improved performance, and quality enhancement. The methodology could serve as a tool for internal audit fieldwork and planning, or it could be used as a basis for advising on Lean Six Sigma projects. Other types of certifications and training could also prove beneficial, especially those that link directly to operational and strategic objectives.

Just possessing these competencies, however, is not enough. Internal auditors also need to make sure clients are aware of the expertise they possess by actively communicating it throughout the organization. They should ensure these capabilities are understood by clients and emphasize the value they can provide to the business. Announcing new staff credentials and competencies via a company newsletter or intranet site, for example, can help increase awareness. Internal audit could also consider meeting with key stakeholders to discuss its capabilities and develop a brochure to promote value-added services.

To cement internal audit's credibility and truly demonstrate its abilities, auditors need to show how

their expertise can be put into practice. For example, audit teams that possess Lean Six Sigma training could look for opportunities where Lean principles can support recommendations for business process improvement. Similarly, fraud, technology, or industry-specific expertise should be leveraged whenever possible for enhancement and support. Audit recommendations can be viewed, in part, as an opportunity to promote the function's value-added services. Moreover, while remaining mindful of independence, internal auditors must actively participate in critical organizational projects underway or about to start.

To make sure the audit function gains recognition as a valued partner, it may be necessary to go above and beyond these conventional skills. By demonstrating a commitment to organizational improvement, internal audit helps position itself as a key adviser and an essential source of expertise.

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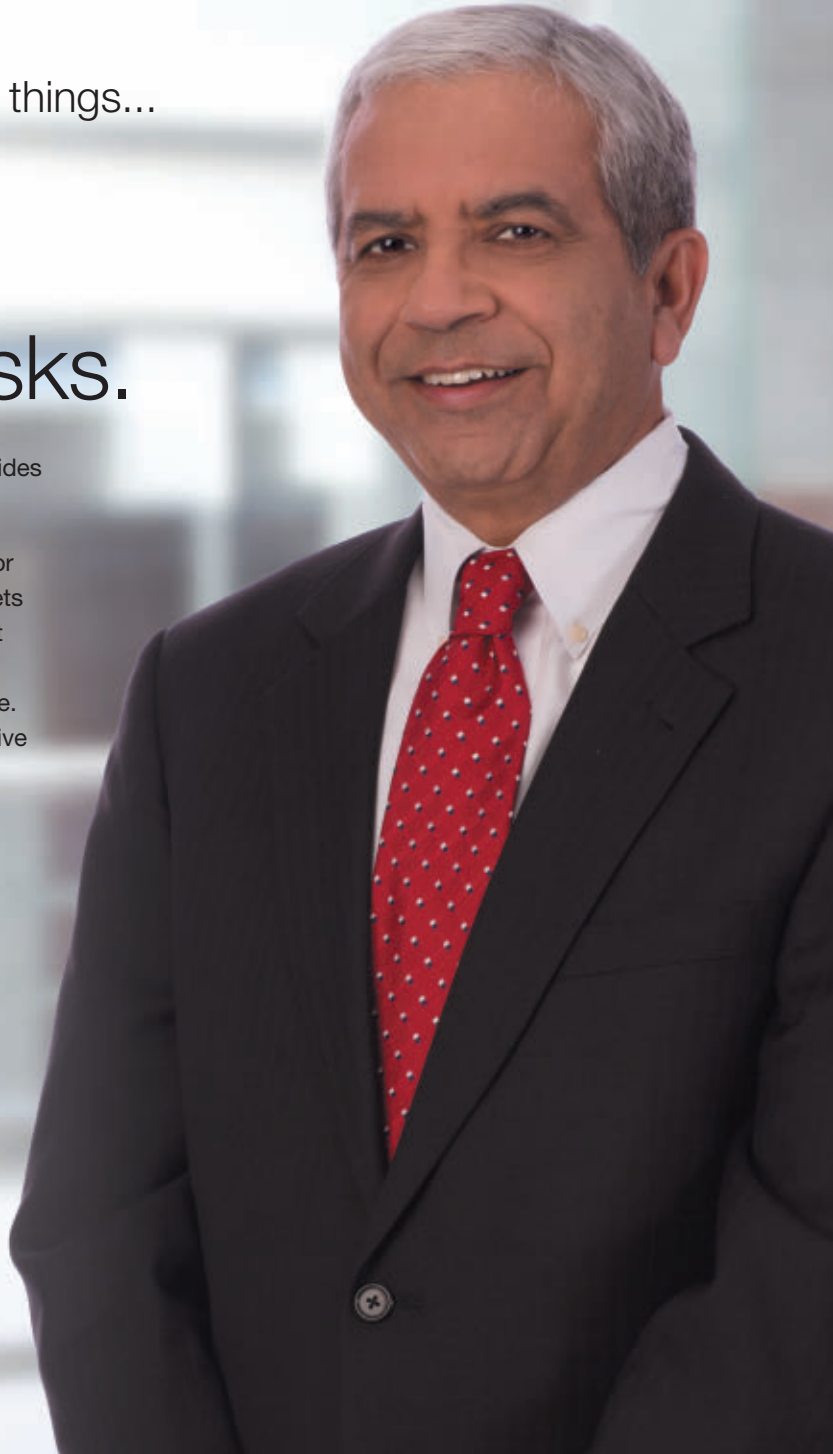
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