



VOLUME III

# INTERNAL AUDITING AROUND THE WORLD

*Profiles of Internal Audit Functions  
at Leading International Companies*

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## INTRODUCTION

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*“When it comes to adding value across the board, there’s no better resource than internal auditing.”*  
– *Internal Auditing: Adding Value Across the Board, The Institute of Internal Auditors*

What drives top-performing internal audit (IA) functions today? *Internal Auditing Around the World*, now in its third volume, tells the stories of 16 successful IA functions and examines common denominators that separate these leaders from their peers. While there certainly are differences among these profiled companies, they share a number of important similarities in terms of philosophies, approaches, performance measurements and lessons learned – and perhaps most notably, the core concept driving IA activities within these organizations is adding value.

Volume III captures innovative voices in a wide range of countries and industries. Organizations from Australia, Brazil, Canada, Japan, Mexico, the Netherlands, the United Kingdom and the United States share insights and experiences with us, in industries as diverse as financial services, nonprofit, healthcare, life sciences, technology, food and beverage, and entertainment. The IA leaders profiled have developed highly effective methods for meeting the challenges brought about by increased globalization and competition, stakeholder expectations and regulatory scrutiny, while striving to add value for their organizations. They do so by providing continuous auditing services; helping to strengthen internal controls; supporting corporate governance initiatives; and offering IA training and guidance to professionals who will continue their careers in key operational, financial and strategic positions throughout the organization.

As an example, at Australia Post, delivering value is defined as providing real-time advisory services to the organization. Dave Mallard, group manager for corporate audit services, believes auditors perform a more central and relevant role than ever before. Using a principles-based approach that is prevalent throughout companies in Australia, Mallard’s team is at the forefront of corporate strategy and change.

To deliver value-added services at U.S.-based Washington Mutual, Randy Melby introduced the importance of differentiators, rather than qualifiers, to his leadership team. Qualifiers are the standard audit processes the IA team must accomplish every day, such as assurance work, audit reports, work paper documentation and training. Differentiators drive the IA team to excellence and underscore its ability to deliver distinctive value to the company.

Given the value added by having strong IA teams, it is not surprising that people play the most essential role in every IA function represented in this book. Demand for highly qualified, talented internal auditors continues to grow throughout the world, as the number of professionals meeting this description shrinks. Most organizations conduct continual recruiting efforts to maintain a robust and effective IA team, with auditors who have not only auditing and accounting backgrounds, but also the necessary interpersonal and communication skills required to build relationships within the organization, as well as the expertise and confidence to work on challenging IA assignments.

Protiviti's *Internal Auditing Around the World* series tracks the growth and evolution of the IA industry and its professionals, who continue to rise to the ever-expanding demands created by the complexities of managing risks, monitoring controls, improving corporate governance and capitalizing on opportunities in international markets. The benchmark is value, and each of the IA functions in this resource guide delivers it. Given this, we remain confident that our ongoing series will continue to be well received by and of value to CEOs, CFOs, boards of directors and IA professionals worldwide.

Protiviti Inc.

June 2007

## Acknowledgements

Protiviti wishes to acknowledge the exemplary leadership of The Institute of Internal Auditors (The IIA), as the IA profession continues to evolve and strive for excellence. The companies profiled here represent this excellence, and we wish to thank them for sharing their IA best practices with us. A special thanks to Nancy Hala for conducting the interviews and writing the insightful company profiles in this volume.



**ABN·AMRO**

## **BUSINESS ADVISORS AND CONTROL EXPERTS: GROUP AUDIT AT ABN AMRO**

ABN AMRO is an international bank that ranks eighth in Europe and 13th in the world based on total assets, with more than 4,500 branches in 53 countries, a staff of more than 105,000 full-time equivalents and total assets of €987 billion (as of December 31, 2006). ABN AMRO is active in four principal customer segments: personal banking, private banking, business and commercial, and corporate and institutional.

ABN AMRO implements its strategy through a number of business units responsible for managing a distinct region, client segment or product segment, as well as expertise and operational excellence that is shared across the organization. Its five regional client business units include the Netherlands, Europe, North America, Latin America and Asia. These business units serve approximately 20 million consumer clients and small to large businesses worldwide. The global client business unit serves more than 550 clients with international needs.

The three product business units in ABN AMRO are Global Markets, Transaction Banking and Asset Management. Global Markets develops products for commercial clients around the world. Transaction Banking involves products designed to cover all payments and trade in the bank for retail, private clients and commercial markets. The Asset Management group is one of the world's leading asset managers, operates from more than 20 locations worldwide, and manages €193 billion worth (as of December 31, 2006) of assets for private investors and institutional clients.

Peter Diekman has been the global head of group audit at ABN AMRO since October 2002. Of the many group functions that support the bank, including finance, compliance and risk, the audit team plays a key role of support and assurance. The organization of group audit mirrors the organization of the bank, with Diekman reporting to the chairman of the management board, as well as the chairman of the audit committee. The audit group's global management committee consists of eight individuals, including Diekman. The team members are each responsible for a region – North America, Europe, Latin America, Asia, Italy and the Netherlands – as well as IT services, group functions and global audits.

The group audit team is large – 985 professionals and a budgeted FTE of 1,000, including Banca Antonveneta in Padua, Italy, which has been part of ABN AMRO since 2006. “As with our compliance function, audit is one of the few departments within ABN AMRO that is organized in a purely global way,” Diekman says. “Each regional head of audit ultimately reports to me.”

With almost 1,000 people working in 60 countries, technology plays a pivotal role in group audit. “Without it, we would be paralyzed,” Diekman says. Lotus Notes is the backbone of the audit team's technology systems, in which working papers are compiled and remote access is supplied to all corners of the world.

Reported audit issues are contained in a database called TRAC, in which all issues are monitored until they are closed. “Only the auditors can close the issue definitively,” Diekman says. “The business line can close an issue, which is recorded as ‘closed, pending validation.’ After that, group audit has to validate the remediation and decide on the definitive close out.”

Other technology that plays a key role in audits for ABN AMRO includes CAATs, such as ACL, and other data mining techniques. “We are in the process of further developing CAATs to assist us in continuous monitoring and auditing, particularly in smaller, more remote branches of the company,” Diekman says.

## A stepping stone for career development

As part of its mission statement, the group audit is a stepping stone for future careers, hiring young graduates and audit professionals alike, and helping them to advance their careers, using group audit as the port of entry into ABN AMRO. Typically, the audit team employs its colleagues for approximately five years before transitioning them to other departments within the organization.

“We feel the constant pull on our people from the other areas of the bank,” Diekman says. “There is a steady outflow of auditors into various business units around the world. As a result, we have had to establish aggressive and continuous recruitment methods in a wide range of markets.”

Once on board, auditors participate in mandatory training, following the guidelines of The IIA as well as those put forth by the International Federation of Accountants. “We bring in professors to teach master’s-level classes to our auditors,” Diekman says. “For example, this spring we finished a three-day master’s class in Chicago that involved a variety of subjects, such as the pricing of options, fraudulent financial reporting, compliance auditing, and professional ethics for accountants and auditors.” In addition to classroom training, on-the-job training plays an equally important role, with auditors putting into practice the formal guidance they have received.

Education is a key component in auditors’ skills. ABN AMRO regularly sends auditors back to school to earn their master’s degree or other postgraduate education, as well as to become licensed as an auditor or accountant. Some advanced degrees held by auditors at ABN AMRO are outside the norm. “We have one individual who is a commercial pilot and another who is a medical professional. Both are in the process of becoming fully licensed auditors,” Diekman says.

Regarding soft skills, Diekman says that he spent considerable time developing leadership qualities within his team. “The top 50 people in our department have completed a leadership assessment process that determines certain leadership styles,” he says. “For example, some leaders have a coaching style, while others take a more authoritative approach. This assessment process gives our people the valuable insights they need to recognize and improve their styles to become better leaders for the company. It’s important for every leader to connect with their team.”

## Group audit goals

The primary objective of the group audit team is to conduct audits that are operational in nature, including the audit of the internal control environment of the bank. However, that is too narrow for Diekman. “When I took office in 2002, I indicated that we had to broaden our audit scope to include finance,” he says. “This stems from increasing scrutiny on compliance, which in turn requires the inclusion of compliance and risk audits in the overall audit scope.”

In addition to finance, risk and compliance audits, group audit also is working with the group security function to establish forensic audit teams to detect any potential fraud at ABN AMRO.

The result is the Control Procedure Report, a quarterly management letter that provides an overview of open audit issues and outlines high-level risks that warrant management reaction. Additionally, twice per year, on June 30 and December 31, group audit produces a “Top Letter” that contains the most important material issues surrounding audit findings. The Top Letter is addressed to the audit committee and supervisory board. Finally, Diekman maintains open communication with worldwide regulatory authorities that align with each area in which the company operates.

## The global audit plan

The work that Diekman and his team perform starts with the global audit plan, which includes more than one million hours distributed over ABN AMRO’s various businesses. “We use two methods in our global audit plan,” Diekman says. “The first is the resource allocation model, which is mathematical in nature and outlines important risk indicators throughout the bank, such as the

number of branches in a given country. Once we run the model, it determines the number of FTE auditors allocated to each region.”

“The second model we apply is the audit risk model, which is a combination of inherent risk, internal control quality and financial materiality. In this model, we create a comprehensive description of the business from a risk and materiality point of view, and then we determine the intensity of the audit.”

Performance is measured by delivery. Diekman says, “We measure how many audits are delivered, as well as direct and indirect chargeable hours.”

As the “eyes and ears” of the global organization, Diekman is an important messenger for the chairman of the managing board, who reacts positively on issues group audit brings forward. “We are advisors with regard to the bank’s governance structure and internal control environment,” he says. “We have an important role, one that is taken seriously by the managing board.”

## Corporate governance

ABN AMRO began preparing for Sarbanes-Oxley 404 three years ago, and group audit led the initiative. “The level of Sarbanes-Oxley awareness at that point was low in the bank,” Diekman says. “Group audit was the first to raise the flag of awareness. We knew that corporate governance compliance would have a major impact.”

The first task for group audit was to establish a 404 steering committee to help build the architecture for compliance, and interpret the PCAOB guidelines, which outlined the ramifications of 404. All of these efforts played a significant role in 2003; yet Diekman believed that it was not truly group audit’s responsibility to lead the corporate governance charge. In 2004, the responsibility for 404 compliance was transitioned to the finance function.

“Group audit helped ABN AMRO design controls of financial reporting,” Diekman says. “On one hand, we helped management identify, describe and record their controls, and on the other hand we trained a team of people to test those controls. While testing control effectiveness is, by law, a management assessment, the execution of it should be performed by group audit. As business advisors, we detect control deficiencies and recommend improvements in time for the company to close out 404.”

In 2007, group audit will be integrating test designs for 404 compliance into the overall audit program, incorporating 80,000 hours for testing and sustaining compliance.

## Active engagement

Diekman’s vision for the group audit function at ABN AMRO is to ensure that all auditors are actively engaged not only in their jobs, but also with regulatory authorities and in academia, such as by writing thought leadership articles on issues such as risk, control and compliance. “We place a high degree of emphasis on independence,” Diekman says. “Group audit at ABN AMRO is independent because of the organizational structure we use. I report to the audit committee and supervisory board, so I have a formal ability to circumvent the managing board if I feel it is necessary.

“However, with 1,000 auditors in the organization worldwide, we should not be afraid to play an advisory role. Auditing is about making an observation of reality and comparing it with a standard, such as a standard internal control procedure. The auditor can provide recommendations to management on how to remediate any deficiencies. Therefore, the auditors should be willing to take a very active role in helping management make improvements.”

Diekman also believes that group audit should apply CAATs much more intensively than it does today. “I am interested in continuous auditing and monitoring,” he says. “It is a compelling concept; we have to make it tangible. We must apply sophisticated statistics, mathematics, query language and access to databases to determine where to audit and where to abstain from audit. We don’t need to audit everything. What we need instead are robust statistical and data mining tools.”



## DELIVERING AUDIT SERVICES ACROSS THE ORGANIZATION AT AUSTRALIA POST

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*The Australian Postal Corporation is part of the fabric of Australian life. Australia Post is a self-funding business that uses its assets and resources to earn profits, which are reinvested in the business and/or returned as dividends to the Australian Government. Australia Post has 35,000 staff, operates 4,500 retail outlets, delivers mail to more than 10 million Australian addresses and serves more than a million customers every day.*

The three core business areas of Australia Post are letters; retail and agency services; and parcels and logistics. Services are delivered by three key operational divisions, support functions, and other subsidiaries and joint venture companies.

The first division is the customer-facing commercial division, which includes a retail network. This division, for example, provides one-stop shopping for home and office supplies, including office stationery, phone products, POSTpak® packaging products and greeting cards, banking and bill payment services, and identity verification. With more than 4,500 outlets across the country, this segment generates most of the revenue for the organization.

The second is the mail and networks division, which is primarily focused on the operations of mail and parcel delivery in Australia and internationally. This key division is heavily operational and involves the largest number of employees.

The third division is Post Logistics, which is the most comprehensive provider of parcels and logistics services within the Asia-Pacific region. Australia Post has several alliances, including an international logistics business – Sai Cheng Logistics International – as a joint venture with China Post.

Dave Mallard, the group manager for corporate audit services for Australia Post for the past eight years, oversees a team of 18 auditors who are supplemented by outsource providers, particularly on assurance audits. Mallard reports to the managing director of Australia Post, with a strong reporting line to the board audit and risk committee. He meets with the audit committee five times per year, in addition to private sessions, and presents summary audit reports at those meetings. Three executive managers are loosely responsible for the corporation's three business divisions, and report to Mallard; however, the team leverages talents across the board and integrates competencies and knowledge by encouraging auditors to work on different types of audits, an approach that also greatly benefits audit clients.

As each divisional audit manager is responsible for making sure that audit action plans are met, Mallard and his team are considering developing and implementing a Web-based tool to provide more fluid access in a timely manner to all relevant audit information, including issues and follow-ups from audit projects.

### Corporate audit mission

According to its charter, the mission of corporate audit services at Australia Post is to provide the board, managing director, management and other key stakeholders with a high-quality, cost-effective and value-added assurance and consulting service to help the corporation meet its objectives. The vision of the corporate audit services group is to be an outstanding team with a passion for excellence, adding value and facilitating change through dynamic people who learn and develop as future leaders in Australia Post.

Mallard, as group manager for corporate audit services, directs a broad, comprehensive program of internal auditing. His team is authorized full and unrestricted access to all functions, property, personnel, records, accounts, files and other documentation. Mallard also has full access to the managing director, the board audit and risk committee (BARC), and the chairman of the board.

## Audit scope

The audit scope encompasses the examination and evaluation of the adequacy, effectiveness and efficiency of the systems of internal control at Australia Post. Internal audit reviews cover all activities of the corporation, together with controlled entities and their commercial activities. These reviews involve all operations – financial and nonfinancial, manual and computerized.

The scope of audit engagements is aligned with the primary risks of the corporation. Mallard's team evaluates the adequacy and effectiveness of the control environment encompassing governance, operations and information systems to effectively mitigate key risks. The services provided by the corporate audit team are broadly categorized into the two following groups:

**Assurance services:** This encompasses risk and control reviews focused on the management and mitigation of key risks within an operational or financial process. These reviews provide assurance that risks are being effectively and efficiently mitigated. Risk and control reviews typically focus on process, compliance with policies, due diligence reviews and fraud investigations.

**Advisory services:** These reviews focus on the assessment of projects or operational processes against desired objectives. These services are often conducted “pre-implementation,” but do not involve the development or implementation of operational procedures or processes. Advisory reviews typically focus on strategic and operational activities, internal control assessments, project “health” checks and pre- and post-implementation reviews.

“We use risk-based auditing methodologies to develop and implement an audit plan,” Mallard says. “This includes facilitating risk assessment workshops across the corporation, in conjunction with management.”

## Finding the right people

According to Mallard, there is an important balance to be achieved in building the most effective audit team. “You have to blend the career auditors with those who want to spend time in audit and then move into the business,” he says. “One way of doing this is to allocate a certain number of positions for bringing people in for a short while, giving them risk management and internal control experience, and then transitioning them out into the business where they can enact corporate governance and risk management improvement.”

Facilitating churn while establishing stability is a difficult balance to strike. “Having come to [Australia] Post from the private sector, I found that the organization was more complex and challenging to manage – but we thrive on cooperation and communication,” Mallard says. “Relationship skills and people skills are the most important components in getting things done. We look for people with emotional intelligence, and a propensity for interacting productively and positively with others. In the end, it's all about the people.”

## Strategic goals

In the long term, Mallard is focused on becoming more strongly oriented and aligned with corporate strategy. “Our group must leverage its ability to analyze our data stores related to the business and identify important trends and risk indicators,” he says. “We have an opportunity to increase the value we deliver by providing additional advisory services to business unit heads. We can do this by making the most of the information we are collecting.”

Recently the team undertook a stakeholder diagnostic survey, a lengthy and broad-based exercise designed to find out what is important to internal audit stakeholders. Mallard's group contacted approximately 65 stakeholders, including the board, managing director, executive committee, middle management and the audit team itself. The goal was to explore what was important to stakeholder groups, track perceptions of effectiveness in service delivery and identify any potential gaps with audit work.

The annual audit plan is risk-based and integrated with the Enterprise Risk Management Framework. "In terms of our audit plan objectives, we also look at change programs and strategic initiatives," Mallard says. "We consult with business unit management and the risk management committee, as well as other stakeholders, to determine what to focus on in the 12-month and three-year time frames."

## Performance Measurements

Performance standards for the corporate audit services team are grouped into three areas:

- Review management and work performance
- Audit effectiveness and service delivery
- Talent management and competency development

"Within those three areas, we have a range of performance standards at both the group and individual level," Mallard says. "At a macro level, we have a stakeholder feedback process in which feedback is ranked. Reaching out to stakeholders on a continual basis is part of our 360-degree feedback effort."

Australia Post seeks to comply with all private sector corporate governance guidelines, in as much as they can be adopted by a government business enterprise. The board has mandated that the corporation observe the Australia Stock Exchange (ASX) corporate governance best practice guidelines, providing sign-offs on risk management and internal controls. As a means of supporting those efforts, the audit team facilitates business unit self-assessments on key financial reporting controls across the organization. This information is cascaded up until the managing director, CFO and board sign off.

"There is a draft that the ASX has released proposing an expansion of the sign-off in all areas of an organization's risk management. If that is adopted, it would impinge on audit in that we already play a key role in facilitating controls documentation," says Mallard. "This would, in effect, expand the already sizable project that we undertake annually, and the organization would spend more time in pulling together an additional suite of documents to support sign-off. In terms of resource limitations, I have not decided whether or not this is a productive step or if it is a bit over the top."

## A real-time advisory function

Today, Mallard says that the corporate audit services team is more focused on risk, control and corporate governance than at any time in the history of Australia Post, playing an essential role in influencing change. "This reflects what is happening in the industry, and not just at the senior management level but across the organization," he says. "Auditors now perform a more central and relevant role. With our principles-based approach, we are at the forefront of corporate strategy and change."

Challenges for the future of Mallard's corporate audit team are twofold. "We will always conduct traditional audits on risk, control and governance, but we need to look forward as well as look back," he says. "The goal is to be a real-time advisory function. To do this we must get the blend right between the real-time auditing and the more traditional – and just as valuable – assurance and compliance work. We have to leverage our systems and data stores, and adopt risk management principles to engage management in a more timely and relevant way than ever before."



## THE IA TEAM AT BUNGE SERVES DIVERSE LOCATIONS, CULTURES

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Bunge Limited is one of the world's leading oil seed and grain trading and refining companies, with businesses ranging from trade and processing of agricultural products, as well as food products, to the production and sale of fertilizers.

Bunge has a decentralized but integrated management and operational structure. The company's headquarters is in White Plains, New York, with operations and sales offices in the United States, Mexico, Canada, Australia, China, Singapore, India, Thailand, Malaysia, Indonesia, Philippines, Spain, Portugal, Italy, Turkey, Switzerland, Germany, Austria, Bulgaria, Hungary, Latvia, Netherlands, Poland, Romania, Russia, Ukraine, France, United Kingdom, Brazil, Argentina, Uruguay and Paraguay.

CEOs at each location lead the regional operations, while the White Plains office oversees the results and ensures that all corporate objectives are met and the vision of the company is followed. Teamwork and unity are important components in Bunge's overall strategy.

Jose Francisco Moraes is the director of global internal auditing, a role he assumed four years ago. Prior to this position, he was the director of South American internal auditing for Bunge. He has worked for the company for 14 years.

The internal audit (IA) group mirrors the decentralized structure of the organization. IA offices have been established in the United States, Canada, Brazil, Argentina, Geneva, Poland, Moscow, Ukraine, Italy, Singapore, China and India. Broad regions are covered by each of these offices; for example, the south of Europe is overseen by the office in Italy. The four regions that report to Moraes are North and South America, Europe and Asia. Through those four regions, Moraes and his team cover risk and controls throughout the world.

"We mirror the decentralization of Bunge because the ways in which we conduct business around the world are varied," Moraes says. "Our business in China is different from our business in the United States. We are results oriented, so rather than try to downplay cultural differences, we make sure they are reflected in our audit scope."

The IA department consists of 25 full-time professional employees, with another 20 provided through a co-source arrangement that allows Moraes to meet special management requests or concerns. "This is an effective strategy for us," he says. "We provide the scope and direction; they provide the service and expertise. I can add or shrink our resources as needed. I prefer to have fewer full-time employees complemented with a wide range of expertise." In addition to offering specific expertise, such as, for example, knowledge about Chinese or Ukrainian controls, the co-source providers also help bridge language gaps in locations around the world.

### The spider and the starfish

With an IA team working in so many different locations, it was important to implement one system to be used by all auditors. "We use a completely paperless system," says Moraes. "Our technology allows us to query, evaluate risk and manipulate huge amounts of data very quickly."

Each region is responsible for maintaining audit objectives, which are identical for all regions but which also have been customized in terms of scope for each location. "I can go to the audit committee and compare the audit findings of Asia, Europe, Brazil, anywhere," Moraes says. "We

all work with the same audit objectives. All audit objectives, strategies and plans at high levels are under my responsibility and are maintained by the director responsible for each region. There are few similarities in terms of how we do business in different regions, but many similarities in terms of how we accomplish Bunge's objectives."

Moraes uses the analogy of the spider and the starfish to describe the need for well-integrated but highly decentralized operations. "A spider is a centralized entity. A starfish is totally decentralized. When you cut off one of the legs of the spider, it may be immobilized. The starfish regenerates a severed limb, but at the same time it continues its normal way of life. In a decentralized company, for every position I need to have a trained and prepared backup; otherwise, I would be immobilized. With our structure, we can respond to all of the diversity of our local regions. Based on our cross-cultural exchange of experience programs, we are able to develop the talents ahead of time."

## Auditing skills

Auditors at Bunge must demonstrate a wide range of expertise, including a deep understanding of derivatives, commodities, finance, international accounting, insurance and more. Moraes sources this expertise from inside the company. He finds auditors he can eventually promote to areas throughout Bunge, wherever they may be needed. The ideal is for the auditor to work with the IA team for approximately four years before he or she is transferred into the larger organization. "To help people grow, we identify their talents and create opportunities for them to work on projects that promote their skills and interests," Moraes says.

The soft skills that Moraes considers mandatory are responsibility, integrity, honesty, initiative and the ability to communicate effectively, interact positively and work as a part of a team. The hard skills required are more focused on the company's business operations. "Most of our operations involve trading soybeans, corn and flour, and producing soybeans and a variety of grains, oils, and meals and more. Depending on the area we are auditing, different skills are needed," he says. An understanding of the company's product portfolio is a must, as well as familiarity with finance strategies, international freight transportation, global distribution techniques, supply-chain management and, as always, the diversity inherent in each location.

Part of this training process also involves assigning auditors to jobs in other regions, in spite of language barriers, which practice has shown are easily overcome with assistance from local auditors and use of English as the common language.

## Risk-based auditing around the world

The IA team performs risk-based auditing at every one of its international locations. "We do not try to eliminate risk," Moraes says. "Like any global trading company, we know that risk can be a great opportunity for profit. The key is to understand how to monitor, manage and control risk."

Moraes looks at economic scenario risks across the globe to scope an audit in the most accurate and effective way possible. For example, in the United States, the economy is stable and reasonably predictable, while in some other areas of the world unpredictability is significantly higher. "This makes a lot of difference in our risk portfolio," he says. "We aim to ensure scenario risk coverage by improving our ability to identify risk trends and honing our skills to communicate these risks and opportunities to the top management and audit committee."

Reputation risk is another important consideration. "Our code of conduct goes very deep in this company," Moraes says. "If we are dealing with suppliers in different countries who are engaged in practices that could damage our reputation, we take that risk very seriously – we are always aware of it as part of our audit scope."

## Performance measurements

Moraes and his team use questionnaires to measure performance, including selected post-audit customer satisfaction surveys done by Moraes with Bunge's managing directors. In addition, Bunge's top management and audit committee monitors the IA department's target accomplishments of audit plans, adherence to budget requirements and any changes that should occur to improve IA performance. Moraes looks for improvement over time. The results of the above discussions and survey help Moraes understand and predict his audit customers' expectations.

"We have a good relationship with management," he says. "Since we are decentralized, we are closer to the management teams. I encourage our auditors to discuss issues with management as much as possible, before and after the audit."

## A governance partner

In terms of the ways in which the IA department supports corporate governance efforts within Bunge, Moraes says, "We try to be a governance partner. We focus on opportunities to enhance controls, strategies or policies that should be applied to a new and/or existing business. To achieve this, we try to use a common language within the operational structures and align our mission to fit both the Bunge management and the audit committee's expectations."

Moraes also strives to discuss, measure and report risks whenever possible, making sure they are immediately identified and addressed. The IA team spends time with business leaders throughout Bunge to stay abreast of the company's risk environment and any upcoming changes or opportunities to support. "When we know where we are and where we have to go, it makes life easier," he says. "We focus on the most relevant risks and help management mitigate reoccurring issues. We try to consolidate our global findings to present management with as many opportunities as possible to be proactive."

The IA role has changed significantly in recent years. The company's rapid growth has required an understanding of emerging business, technologies and regulations. "I have taken the opportunity to push our IA team to be as close to management as possible, so that we can add more value and be part of the governance of the company, as independent advisors, partners and risk management experts," Moraes says.

## Planning for the future

Moraes has a clear vision for the future of the IA team at Bunge. He seeks to develop and incorporate new capabilities and broaden the spectrum of services offered. Of the many initiatives he is working on, some include:

- **Objectives:** "The IA team is going to move from minimizing risk to maximizing corporate objectives. We have several kinds of risk – some more important than others. We should upsize the corporate objectives, not just downsize risk."
- **Reputation:** "We need to monitor how our company is perceived and how we are meeting our social responsibilities."
- **Pricing:** "Auditing the effectiveness of our pricing program is essential for long-term success."
- **Regions:** "Different regions continue to require different talents. I intend to improve the ways we can assist management in this arena."
- **Risk:** "We have to change our risk frontier. In the future, management and the audit committee will continue to be deeply involved [in] defining what our risk frontier should be in each region we are doing business, and also will develop, around the world, different tolerance for certain risks. Then, the IA team will assist management to ensure they are adequate to business dimensions, as well as under control."



## THE INTERNAL AUDIT TEAM AT CA HELPS THE COMPANY ACHIEVE ITS VISION

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CA, one of the world's largest information technology (IT) management software providers, creates products that help unify and simplify complex IT environments across organizations. The company's signature Enterprise IT Management (EITM) solution represents its vision for the future of IT, helping businesses achieve better results by managing systems, networks, security, storage, applications and databases securely and dynamically.

More than 5,300 CA developers worldwide create and deliver IT management software. Founded in 1976 and headquartered in Islandia, New York, CA is a global company with 150 offices in more than 45 countries. With 2006 revenues of \$3.8 billion and more than 500 patents (as well as more than 1,000 pending patent applications worldwide), the company serves more than 90 percent of Fortune 1000 companies, as well as government entities, educational institutions and thousands of other companies in diverse industries worldwide.

The company is organized according to its primary business units:

- Enterprise systems management
- Identity and access management
- Storage
- Business service optimization (software that helps optimize business processes)
- Security

Marc Loupé joined CA as a senior vice president and general auditor in August 2005. As chief audit executive, Loupé reports to the audit and compliance committee chairman and to the executive vice president of global risk and compliance. He oversees a department of approximately 20 auditors who all take an enterprisewide view of the business and a risk-based approach to auditing. The groups that comprise the internal audit (IA) team and report to Loupé include forensics, financial/operational compliance, IT, risk management assurance and international.

The IA function at CA has improved and evolved dramatically in the last two years. At one point, the federal government had assessed the IA department and required the company to substantially enhance its IA function. During 2004 and through mid-2005, the IA department concentrated fully on assisting in Sarbanes-Oxley testing and did not perform any audits. In August 2005, when Loupé assumed his role, the department began its transformation toward adhering to The IIA standards and striving to become a best practices-oriented organization. Additionally, Sarbanes-Oxley testing was moved to the internal controls function within finance. Primary areas of focus became worldwide staffing, automation, launching enterprise risk management, audit committee and executive management reporting, and risk-based audit.

### The strategy of recruiting

The first step was to begin strategically recruiting auditors to the team. Loupé's initial focus was on hiring senior-level professionals to help lead the function toward its goal of becoming best practices-oriented. The use of executive search firms and networking among other internal audit colleagues were critical sources for locating professional talent.

To identify and attract graduating college students, the IA organization developed relationships with academia, including New York University and Long Island University. “In Year Three of our new existence, we plan to be able to bring personnel onto the IA team from inside the CA business. We cannot do that now because we are still developing our infrastructure, which centers on people, process and technology,” Loupé says.

The skills Loupé searches for in auditors include experience relating to accounting, auditing, finance, global business operations, risk management and information systems, such as various operating systems (including MVS, UNIX variants and Windows); programming languages; ERP applications; middleware; and databases (SQL, Oracle, DB2). Important soft skills, according to Loupé, include the ability to interact and engage with management and adopt a proactive mindset. He strongly believes oral and written communication skills are paramount for an effective IA function.

“We are not yet in a sustainable mode,” Loupé says. “We are in a transformation phase, so we need auditors who are balanced in their view of controls and can help the business implement and critique the organization’s controls. Our auditors are not policemen; they understand CA’s business direction and at the same time, possess the skills we need to drive the IA function to new levels of achievement. Top management here like the fact that I have not spent my career solely as an auditor; throughout my career, I have held different roles that have given me a more comprehensive business perspective. We need people who can combine business-oriented and controls-oriented viewpoints.”

## Goals and objectives

When Loupé stepped into his role in 2005, he had two mandates: The first was to create an effective IA department. The federal government had stipulated that an effective IA organization was a business imperative, so this was one of the principal areas CA had to work on in its deferred prosecution agreement. The second mandate came to Loupé from the chairman of the audit committee, who wanted to ensure there were no surprises in the internal control structure at CA.

“Initially, there was a lot of ground to cover,” Loupé says. “We had to embark on adhering to the standards of The IIA. We performed an external quality assurance review (QAR) so that we could assure the audit committee and management that we had been critically assessed by an external qualified entity.” The QAR results were positive and there were no “nonconforming” determinations.

Today, the IA team assigns owners and achievement ratings to monitor progress on strategic initiatives throughout each quarter of the fiscal year. The scorecard includes the following components:

- Quality
- Deferred prosecution agreement compliance
- Project completion performance
- Stakeholder communication
- Financial performance
- Professional development
- Stakeholder satisfaction

“We use the scorecard to get things done and maintain our focus,” Loupé says. “It’s critical for us to monitor our performance and ensure efficiency and effectiveness in our IA operations.”

## Building relationships

Loupé follows a number of best practices to build strong relationships with CA management and to ensure that the CEO, audit committee chair and other top executives demonstrate sponsorship for the IA department, its mission and team members. These include:

- Using a quarterly “rolling” risk assessment and audit planning methodology well-suited to CA’s rapidly changing environment
- Developing a unique partnership with human resources to create an effective recruiting program and formal approach to ongoing organization development
- Reporting on IA performance metrics to senior management and the audit committee chair
- Proactively soliciting stakeholder input through frequent informal meetings and formal questionnaires

“I try to make sure that IA management is partnered with senior-level people,” Loupé says. “We are not just auditors, we are business partners. Yet, we ensure that we remain objective in fact and appearance.”

As stated previously, the IA team played an essential role in Sarbanes-Oxley-related initiatives in 2004 and 2005. This year, the planned involvement for the team is one of oversight. “Sarbanes-Oxley belongs under the jurisdiction of finance, not IA,” Loupé says. “We provide a valuable oversight perspective on the initiative. When I took this role, the IA department was 100 percent focused on Sarbanes-Oxley; now, we spend considerably less of our time on those efforts.”

## Changes and challenges

During Loupé’s tenure, the change and accomplishments in the IA function have been significant. The team has succeeded in upgrading overall staff capacity in IT and international auditing. IA staff training also has improved and now includes change management, accounting and business issues within CA, internal auditing issues outside CA, emerging business issues, roundtable discussions with members of the C-suite and face-to-face independent examiner exposure.

“In addition to the tools and the performance scorecard we have implemented, we have also launched enterprise risk management, modifying it to fit the CA culture,” Loupé says. “In 2007, CA is still evolving. We are moving from being a founder-led company to a governance- and business-oriented culture with more autonomy and democracy. As we evolve, more gaps will emerge. The challenge for the IA team is to keep our fingers on the pulse of change.”



## FOSTER'S GROUP: AN INTERNATIONAL BRAND WITH A STRATEGICALLY ALIGNED INTERNAL AUDIT APPROACH

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*Foster's Group is a premium global multibeverage company that produces and distributes beer, wine, spirits, cider and nonalcohol beverages around the world. It is a truly international brand.*

In Australia, Asia and the Pacific regions, Foster's leads the beverage industry, producing such favorite brands as Foster's Lager, Victoria Bitter, Crown Lager and the region's finest wine brands including Wolf Blass, Penfolds, Rosemount, Yellowglen and Lindemans. Foster's serves more than 38,000 customers in these regions, from wholesalers and importers to hotels and restaurants. As part of its unique cross-category drinks portfolio, Foster's operates three distilleries, two cideries, six breweries and 16 wineries. Employing approximately 6,200 professionals, Foster's sells more than 120 million nine-liter equivalent cases across the region annually, with export brands growing swiftly in key markets such as Japan, China and India.

In the Americas, Foster's produces and markets an international portfolio of premium quality wines, including boutique and leading brands that form part of Foster's Californian wine portfolio – Chateau St. Jean, Chateau Souverain, Etude Wines, Greg Norman Estates, Stags' Leap Winery and Meridian Vineyards. The Americas is a major market for Foster's, fueled by licensing and distribution agreements in Canada and the United States, and export agreements covering key markets in Central and South America. With annual beer sales of 6 million cases and wine sales of approximately 20 million cases, Foster's Americas employs 1,400 people.

Finally, in Europe, the Middle East and Africa, Foster's markets a range of the United Kingdom's and Europe's favorite "new world" wines, with Ireland and the Nordic countries representing key growth markets for its wine brands. Foster's has the strongest premium import portfolio in the United Kingdom and Europe. The company has 140 employees in Europe, the Middle East and Africa, with annual sales in these regions of 7.5 million nine-liter cases.

Dr. Craig Nisbet is the group audit manager for Foster's Group, a position he has held for more than two years. Nisbet has been with the company for 11 years in a variety of team leadership roles, principally in finance; however, prior to his current role, Nisbet was the company's group risk manager and responsible for internal audit (IA), risk management and assurance services. Two years ago, the company divided these three roles to ensure independence in the IA function, in keeping with corporate governance trends. Nisbet maintained responsibility for IA where key challenges prevailed, while his colleagues were appointed to expanding the foundations laid for the risk management and assurance functions.

### A measured approach to continuous improvement

The IA function at Foster's is supported by an effective outsourcing arrangement with a provider. The risk management and assurance functions are each operated by two managers, who also have the support of outside providers. "This approach is successful partly because we always ensure that someone is managing the work with a company viewpoint," Nisbet says. "For the IA function, the actual fieldwork is done by the provider, but I am involved in planning, scoping, getting management buy-in and, ultimately, reporting to the audit and risk and compliance committees."

Nisbet has a dual committee reporting role. On operational areas, he reports to the risk and compliance committee, and from a financial perspective, he reports to the audit committee, to assist

the board in determining the effectiveness of financial reporting and to help management meet its requirements in responding to the Australia Securities Exchange (ASX) guidelines. “With our work, we help management sign off on the adequacy of risk and controls, a process that is modeled on Sarbanes-Oxley in the United States,” says Nisbet. “In Australia, we have a principles-based approach, as opposed to the strict regulations of Sarbanes-Oxley.” Nisbet points out, however, that all large companies in Australia comply with the regulations; not doing so means having to explain why in the annual report. “In effect, it is law,” he says.

Technology helps Nisbet meet his responsibilities. For tracking IA issues, he uses Methodware, which allows the updating of findings, monitoring of progress and facilitation of management response to audit issues.

## Why outsource?

It is important to be flexible in resourcing a world-class IA function – whether it be insource, cosource or outsource – to support the needs of the company at a particular time. When Nisbet joined Foster’s Group 11 years ago as part of its in-house audit, it wasn’t long – only six months – before the decision was made to outsource. “This was primarily decided from a cost standpoint,” he says. “However, other reasons also came into play. For example, the audit committee wanted complete objectivity. They believed there was a fine line between doing the work and reviewing it, and for this reason, they wanted an outsourced team.”

Other issues included resource scarcity and the acknowledgement that chartered accounting firms had the most knowledgeable and experienced staff available at the time. Nisbet moved into the finance function, which had experienced his IA work firsthand. He led a small team with the objective of overhauling the department by centralizing statutory reporting responsibilities, which included developing and implementing improvements to the year-end statutory accounts and taxation process. After three years, he was asked to manage the risk management function, which incorporated risk management, business continuity, assurance and IA.

“One of my first tasks was to understand the costs and benefits of the IA outsourcing arrangement,” Nisbet says. “As in any outsourcing arrangement, it is crucial to have a formal strategic measurement framework to ensure you are able to evaluate whether the outsourcing has been and will be effective in meeting the company’s goals and objectives.”

## Goals and objectives

As stated, the IA function is divided into operational and functional work, and for each, Nisbet reports to different committees. On operational reviews, his approach is risk-based and includes the following:

- Challenging the effectiveness of mitigating controls established to manage major operational risks
- Providing coverage of the management of operational risk consistent with the board committee charters and the board’s ASX governance obligations
- Completing diagnostic internal audits of operational processes to establish if they can deliver the required business outcomes: effective and efficient processes

“We use specific methodologies and take a risk-based approach to auditing, dedicating resources toward the high-risk areas we identify based on our ERM program,” says Nisbet. “For example, this year we are focusing on areas such as inventory management, global supply chain processes and the implementation of new IT systems.

“The key is to add value by conducting effective, results-oriented audits and seeking ways to facilitate the company’s strategic goals today and in the future. The challenge in adding value and being called

on by management to participate in the process is to ensure we do not get involved in the decision-making and lose our independence and objectivity. This is more difficult than it sounds and can become a very fine line to walk.”

Nisbet adds, “With our global operations and distribution channels, a critical risk for us is supply-chain management, both from a short- and long-term point of view. Overall, the risks we look at emerge from the risk management group, which reports those risks to the risk and compliance committee.”

Financially, the approach focuses on the ASX guidelines and CLERP 9, a comprehensive program of corporate law reform. “Whereas Sarbanes-Oxley was all encompassing, including both risk and financials, CLERP 9 looks at financials and the completeness and accuracy of reporting; CFO and CEO written assurance; and meeting the needs of external auditors,” Nisbet says. “We perform testing to the standards of external auditor testing requirements, and we do so to ensure there is no duplication between internal and external audit, thereby ensuring efficiencies and effectively managing the costs to Foster’s.”

## Performance measurement

To make sure they are doing “the right things, right,” Nisbet measures performance in a number of different ways. “We focus on audit coverage and impact to make sure we are not missing anything relevant for the business,” he says. “In terms of monitoring performance, we have a number of KPIs that must be met, such as budgetary requirements, audit reporting turnaround time and issues managed and cleared by the business.”

“Our customer satisfaction surveys provide detailed feedback that helps us improve our performance as well as our customer relationships. Among our worldwide colleagues throughout Foster’s, there is a perceived value of audit, as well as an entrenched viewpoint on the experience that our colleagues have with the audit team. Our senior audit outsource team includes three partners, with operational and risk experience. The high level of our outsource team has helped us cement customer relationships and improve performance.”

According to Nisbet, the IA function has established a partner relationship with executive management as key advisors, particularly in the operational risk areas, but also with financial reviews. “They can see how we help them achieve their objectives,” he says. “Providing management at all levels with a valued, knowledgeable, independent view on strategic and operational matters is important to us.”

## Corporate governance recommendations

The ASX recently issued some modifications to the Corporate Governance Best Practice Recommendations, including around Principles 4 and 7, which perhaps have most relevance to IA, but also to other principles that may increase an IA role. These modifications have an impact on Nisbet’s IA function. “We have written a response to this,” he says. “Whilst we agree with the general direction of the changes, we are concerned that these changes can be open to misinterpretation and may be considered far more encompassing than people are aware. Currently, our view is that the modifications require us to describe all our risks and what we are doing to mitigate them. This means that, from a confidentiality standpoint, we are sharing all of our mitigation strategies with our competitors.”

Nisbet explains that, because Foster’s accomplishes much more in the form of risk management and assurance strategies, the company would be compelled to potentially provide significantly more information than competitors – information about supply chains, for example.

Along with corporate governance recommendations, the nature and level of interaction with key stakeholders, such as the audit and the risk and compliance committees, has changed. “Fortunately though, right from the start the company has recognized the importance for good governance, which

is one of the reasons we split audit, assurance and risk,” he says. “I’m more comfortable with that and, importantly, management is benefiting. ASX provided the impetus, but generally, it was headed in that direction anyway.”

## Vision

Above all, Nisbet says it’s critical to remain independent and objective in his IA work. Also, to a certain extent, he says that Sarbanes-Oxley has changed the focus. “A few years ago, more of our program was risk-based and now we are focused on traditional financial reporting,” Nisbet says. “We will no doubt swing back to operational, which is where it should be – more focused on risk.”

Staffing also promises to change in the coming years. “Getting the right resources is a critical issue,” he says. “There is quite a shortage in our field. People see IA as a channel to moving to another part of the company instead of as a career in and of itself. That is a challenge. I believe that the educational bodies must push it. We don’t have IA-specific courses in Australia as they do in the United States. In Australia, we developed a risk management standard that preceded COSO, but in other areas, such as education, we are behind. In the United States and around the world, there are many centers of IA excellence, but not in Australia. This is a challenge for the profession as a whole.”

Nisbet notes that a key challenge for all IA functions in the current business environment is to stay relevant, focus on the things that matter, and be flexible about structural, operational and strategic changes.

“Businesses are assessed with regard to their need to continually improve, reduce management expense and maintain compliance, control and assurance,” Nisbet says. “Foster’s is consistently vigilant about its need to think laterally about how IA is structured, so that it can continue to support the business. This may mean outsourcing, cosourcing or insourcing.”



## GRUPO BIMBO: A WORLD-CLASS BAKER BUILDING A WORLD-CLASS AUDIT TEAM

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A leader in the international baking industry, Grupo Bimbo was established in Mexico City in 1945, and has become one of the largest global producers of baked goods and other food products today. Grupo Bimbo and its subsidiaries produce, distribute and market more than 5,000 products in Mexico, the United States, Argentina, Brazil, Colombia, Costa Rica, Chile, El Salvador, Guatemala, Honduras, Nicaragua, Peru, Venezuela, Uruguay, the Czech Republic and China. The company operates 72 plants and three trading agencies. In 2006, Grupo Bimbo reported net sales of U.S. \$5.9 billion.

Guillermo Sánchez has been the director of corporate auditing at Grupo Bimbo for the last eight years. He started his tenure with the company as an accountant and joined the auditing team in 1998. Grupo Bimbo is divided into three main divisions: Mexico, the United States and Latin America. Sánchez reports to the chairman of the audit committee, as well as to the CEO of Grupo Bimbo, who, in turn, receives reports from directors of the three main divisions and from the company's auditing, finance and personnel functions.

In Mexico, the audit team consists of 74 professionals, with an additional nine in the United States and eight in Latin America. Seven managers report to Sánchez; five of them are in Mexico, one is in Fort Worth, Texas, and another is in Buenos Aires, Argentina.

The audit function is divided by specialty; auditors are devoted to specific functions, such as manufacturing, shipping, commercial, accounting and information technology (IT). “Our commercial auditor evaluates the processes related to how merchandise is received and returned. Our accounting auditor assesses accounts payable, receivables, taxes and more. Part of the team conducts audits internationally, and part acts as local auditors,” Sánchez says.

To enhance communications among auditors who are located in these three geographies, as well as during audit assignments around the world, Sánchez's team uses Lotus Notes and Auditor Assistant. “All the tools that we use, such as ACL, which is one of our more powerful tools, have proved to be extremely helpful to us now that part of our team is dedicated to working on remote audits,” he says. “In these cases, our team members can go to an audit location, extract the necessary information from the site, and then – if everything is more or less running smoothly – perform the audit here in Mexico. If we find something wrong, we will perform and finish the audit at the location. This system is effective and efficient. We get our audit results in a very timely fashion.”

### The importance of teamwork

Sánchez looks for professionals with higher education degrees, such as CPAs, engineers and IT specialists. “If they have a master's degree, that is ideal,” he says. “If they do not, we promote them to attain one, or to continue their education in some other way. Our auditors must have computer skills, we prefer if they speak English fluently (and 50 percent of our auditors do), and they must be experienced in their specialty. For example, a manufacturing auditor must have operational experience in manufacturing plants.”

“The most important quality I look for is an auditor’s ability to be a part of a team,” Sánchez says. “We place a great emphasis on teamwork and team-building. We want people who are self-motivated and who can work with others resolving conflicts and making decisions.” Other attributes he looks for include good oral and written communication skills.

## Measuring performance and achieving the mission

The audit mission is simple: To be the strategic partner for every vice president, manager or director in the company, helping to facilitate control or risk assessment targeted on risks that are most relevant in each division. “We also want to develop leaders in our department and launch them through the company to take positions at all levels within Grupo Bimbo. In this way, we can help increase management awareness of control and self-assessment over the long term,” says Sánchez.

The audit mission is modeled on the COSO framework, which guides the auditors’ risk assessment strategies. “Everything we do follows the COSO framework, and with IT audits we follow COBIT,” Sánchez says.

Performance measurement is just as straightforward: The team tracks the number of audits performed and compares the amount of money the audit team expends against the savings it generates for the company. “During the audit, we note the savings that are generated through our findings and recommendations, and we calculate the amount of money we are saving the company through our suggested improvements,” Sánchez says. “We track those savings in each of the audits we perform, and compare them against how much we are spending as an audit function.”

For most of the year, the team saves more money than it spends. In addition to this metric, every audit is followed by a customer satisfaction survey that asks audit customers to rate a wide range of aspects related to the audit, for example, audit execution, results, the value added and the teamwork displayed among members of the audit engagement.

A final indicator of performance is hours devoted to each audit, compared to the hours outlined in the audit plan. However, this metric is only used internally within the audit department for forecasting resources needed for future audit engagements.

## Building relationships

Sánchez and his team are committed to close collaboration with Grupo Bimbo audit customers. “Effective collaboration is part of our mission,” he says. “Auditors cannot work in a relationship that is combative. We always look to work as a team with the auditees and are focused on building relationships throughout the company.”

To help audit customers understand the auditors’ perspective, Sánchez asks all vice presidents, managers and directors of the company to come to the audit function, one by one, and perform an audit with the team. “This is a permanent aspect of our training program,” he says. “All the vice presidents, managers and directors must conduct at least one audit with us. They typically spend one to two weeks participating on the audit. Sometimes they are asked to travel with us. We do this so that they understand the way we audit and why we do what we do. They delve very deep into our process. We show them the way we think, the way we gather information, how we handle that information and, finally, how we develop the audit report and presentation.” Sánchez says the feedback he has received on this relationship-building initiative has been overwhelmingly positive and helps the executive team regard the auditors as consultants, partners and experts in control.

## Complying with Mexican corporate governance laws

Grupo Bimbo is not subject to Sarbanes-Oxley guidelines, but does follow corporate governance regulations for Mexican public companies. A new law introduced in Mexico, named Ley del Mercado de Valores, has many of the same attributes and requirements as Sarbanes-Oxley, and has prompted Grupo Bimbo to change many aspects of its corporate governance. For example, the audit committee now consists of 100 percent independent members. Additionally, Sánchez's team is dedicating approximately 30 to 40 percent of its time ensuring the company is in compliance with this new law. "We are changing," Sánchez says. "We have to deal with lawyers and accountants and everything that has to do with corporate governance."

One of the most important changes to date for the audit team at Grupo Bimbo has been the level to which awareness has been raised on the issue of internal controls. "When I took this position eight years ago, the image of the audit function was as the watchdog of the company," Sánchez says. "A new CEO came in with new ideas, with a vision for the future of the audit function – Daniel Servitje. He gave me the opportunity to change that image, and we have now a team of professionals who are sensitive to everything that is related to control."

"Today, the image of the audit function is totally different. We are no longer the watchdog. Now, we are the consultants," says Sánchez.

## Challenges ahead

Grupo Bimbo is a fast-growing company, entering new markets every year and improving business processes to meet increasing demands. For Sánchez, this growth presents challenges. "The easiest way to face the growth is by adding people, but this is not always the best way," he says. "In some cases we may have to outsource parts of the audit. Since 1998, we have grown in headcount every year. I have had to speed up the training process because now it takes me about four to five months to train an auditor, after which he or she can perform the audit autonomously. With our accelerated growth, I must train auditors in a shorter time frame."

Other challenges include IT audits. Since everything in the company's corporate auditing is related to IT, Sánchez is trying to conduct only paperless audits, which requires further IT training for his auditors.

Finally, corporate governance continues to present opportunities for change. "Every day, there are new requests for information and new ways of presenting disclosures," he says. "We must assist all corporate governance efforts, and this is a time-consuming task."



# Lloyds TSB

## TRANSFORMING THE GROUP AUDIT FUNCTION AT LLOYDS TSB

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*The Group Audit department at this worldwide financial services organization aims to be best in breed in 18 months.*

Lloyds TSB is a leading worldwide financial services group formed in 1995 with the merger of the TSB Group and the Lloyds Bank Group. During the last three years, the U.K.-based organization has divested a number of its overseas operations to focus on core markets. In 2005, Lloyds TSB employed approximately 67,000 professionals and reported total group assets of £310 billion, with a market capitalization of £27.4 billion.

Martyn Scrivens has been the director of Group Audit for Lloyds TSB since October 2003, and Gavin Martin has been the head of Audit, Methodology and Standards since June 2004. Scrivens was a partner with Arthur Andersen for 24 years as part of the audit division with responsibility for the risk management practice in the United Kingdom. Martin's expertise is in external audit, having spent 11 years with Arthur Andersen and Deloitte & Touche.

Business operations at Lloyds TSB are structured along three primary operating divisions: U.K. Retail Banking, Insurance and Investments, and Wholesale and International Banking. Those three customer-facing divisions are supported by group IT and operations. In addition, Lloyds has a number of central functions, such as finance, risk management, HR and audit.

The Group Audit team is comprised of 230 auditors who are principally in London, and all but 10 are in the United Kingdom. Scrivens reports to the CEO and chairman of the audit committee and has a Group Audit management team reporting directly to him. The Group Audit management team, comprised of three audit directors and an HR specialist, is supported by a broader team called the Group Audit Delivery Team, which includes audit directors and heads of audit. Martin, a member of the Group Audit Delivery Team, is one of those heads of audit. "The Group Audit Delivery Team represents our matrix management structure, so the audit directors interact directly with the operating divisions of the company," says Scrivens. "So, we have an audit director who interacts with the U.K. Retail Banking division, one who focuses on the Wholesale and International division, one who faces insurance and investments, and one who deals with IT and group functions. Meanwhile, the heads of audit are leaders of specialist teams." Martin, for example, leads the methodologies and standards team, and there are audit heads who are in charge of credit audit, market risk audit, IT and systems, project management and change, regulation and compliance, and finance.

### Developing new staffing strategies

Key performance measures around Group Audit's human capital include a targeted turnover rate of 20 percent per year. "We expect to recruit 50 percent of intake each year from within the company, and 50 percent from outside the company, all with the appropriate audit and accounting skills," says Scrivens. "We expect more than 50 percent of the people who leave us each year will go into other parts of the organization. We aim to provide a training and management development function for the people who pass through our management-trainee program, and we aim to be a recruiter of skilled resources from the external marketplace. We are currently heavily recruiting qualified auditors, as we have yet to reach an equal balance of qualified auditors and business specialists. Currently, we have more business operations professionals than auditors."

In fact, the Group Audit team is in the midst of a significant transformation program. When Martin and Scrivens joined the department, it consisted almost entirely of business professionals, with few qualified auditors. The focus of the department had more to do with a traditional inspection role than with the role of business consultant, risk and control specialist, and strategic partner. Martin and Scrivens are working to change that focus.

“Our wish is to be best in breed within 18 months,” Martin says.

The hard skills Martin and Scrivens are seeking include expertise in market risk and credit risk management, IT and systems audit, financial audit, change management, and regulation and compliance. “We are looking for professionals with experience in the financial services industry with skills around retail and corporate banking, and life and general insurance. We prefer recognized United Kingdom and international accounting qualifications, as well,” Martin says.

Excellent communication, relationship management, and skills related to team leadership, project management, and the ability to appraise performance and develop people, are some of the softer skills they seek.

## Transforming to world-class

The journey to becoming best in breed in 18 months began with the first step of developing a mission for Group Audit. The mission is to make a significant tangible contribution to the success of Lloyds TSB by providing independent and objective assurance to the executive committee and the board of directors regarding the effectiveness of risk management, control and governance processes. The mission includes helping business leaders effectively deliver on strategy.

The focus of this mission was further sharpened through three distinct lenses: customer, infrastructure and people. These strategic objectives and a corresponding framework were developed in 2004:

### *Customers*

- Deliver accurate, timely and fairly constructed audit reports
- Audit what matters to the business and to the organization
- Provide expertise in risk management and in internal controls
- Provide an informed assessment on the capability of the business to execute its plans
- Maintain Group Audit’s reputation as a credible provider of objective audit services

### *Infrastructure*

- Construct and deliver a dynamic risk-based plan
- Apply rigorous quality control
- Maintain availability of audit skills
- Foster a thorough and up-to-date understanding of business objectives and plans
- Optimize resource utilization and structure
- Maintain strong customer relationships
- Use efficient and effective tools and methods
- Build strong relationships with regulators
- Communicate well

## People

- Attract the best people
- Provide a focused training and development curriculum
- Ensure people are well motivated
- Ensure they are empowered

“We have made significant progress on this framework, including the objectives we have defined as well as our target outcomes,” says Martin. “The framework is effective in helping us determine our key outcomes around financial performance, customer delivery, contributing to the development of the business, managing risk and developing people. We have a balanced scorecard that is metrics-driven and that directly links back to these objectives.”

In April 2006, Audit Directors Round Table profiled the Lloyds Group Audit infrastructure as a world-class framework. The article, which focused on how the Group Audit team links internal audit strategy to overall corporate objectives, describes the two key ideas behind the infrastructure: First, it defines metrics based on departmental key objectives, and second, it clearly assigns specific metrics to each staff member in order to drive departmental performance improvement.

Another world-class methodology is one that Martin developed, a principles- and risk-based audit methodology comprised of two components:

1. **Selecting the audit.** “To select what we will audit involves our targeting methodology,” Martin says. “We obtain information from the business on where risks reside within their departments. Those risks are identified by the risk category in which they reside, using the organization’s risk language, and they are further defined by process – for example, customer satisfaction. We also conduct an assessment of our internal control framework and how it links to the different elements of the COSO control framework language – this gives us a broader and more complete view of risk.”
2. **Applying the execution methodology.** “This principles-based methodology guides us in our audit work,” Martin says. “The key feature of this methodology is that it is also linked to the COSO control framework. We have designed our audit approach to correlate with the aspects of the control framework that we want to test, giving us a clear principles-based approach to sampling and testing.”

Importantly, performance measurement is linked to the strategic objectives of the organization as a whole, not merely the Group Audit department. “We also have appraisals at the end of each audit engagement that are qualitative rather than quantitative in nature,” Scrivens says.

## Changing relationships

The relationships between business unit management and the Group Audit team are evolving as the team itself transforms. “There has been a significant change that the businesses have had to go through as we have changed our focus,” says Scrivens. “Two years into our transformation process, senior management is now extremely enthusiastic about our vision for Group Audit. They are eager for us to complete our change program.”

Initially, Scrivens explains, the business units were concerned that Group Audit was moving away from the role of “first line of defense” control processes, and into the direction of assessing the control framework. “The individual businesses were concerned that we would be providing less effective assurance to them on the operation of frontline control processes,” he says. “We have helped them understand the importance of the change we are bringing about. We are working to achieve the requirements of the board of directors, as well as strategic organizational requirements, by helping each business unit within Lloyds TSB reinforce the strength of its own control framework. In this way, we are helping the business units develop their own assurance programs to replace the

work performed previously by the Group Audit team, only much more effectively. All of this has demanded a sustained program of communication and education from Group Audit.”

This balanced transition program helps ensure that the business units improve their own frameworks and migrate to more effective, holistic, top-down, risk-based auditing.

### Vision for the end state

There are three aspects to the vision embraced by Martin and Scrivens. The first is that Group Audit is clearly acknowledged as a best-in-breed audit function. The second is that Group Audit achieves recognition from external auditors and regulators, who, in turn, place as much reliance as possible on Group Audit’s role with regard to the governance structure of the organization.

Finally, Martin and Scrivens intend for the Group Audit team to provide meaningful positive assurance to the business regarding the effectiveness of the business control frameworks that enable them to deliver their strategic plans. “We aim to ensure that the control frameworks help the business units deliver what they said they would deliver,” Scrivens says. “This is a much broader form of assurance than most internal audit departments aspire to. It is much more forward-looking and dynamic.”



## MANAGING RISK IN THE GAMING INDUSTRY: MGM MIRAGE INTERNAL AUDIT

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MGM MIRAGE, one of the world's leading hotel and gaming companies, owns and operates 23 properties located in Nevada, Mississippi and Michigan, with investments in three other properties in Nevada, New Jersey and Illinois. Employing more than 70,000 employees, MGM MIRAGE is a holding company for numerous operating properties that are either owned wholly or through joint venture investments. The company is currently building a premium resort in Macau, scheduled to open in 2007, and will soon be involved in non-gaming resort property developments in the Middle East and China.

Bob Rudloff – the vice president of internal audit at MGM, who joined the company after leaving a Big 4 accounting firm in 2003 – has had a 26-year career primarily focused on internal audit (IA). The IA team he oversees consists of 90 professionals: most are in Las Vegas but several work at property-specific departments in Detroit and Mississippi. Work is divided along functional, rather than regional, lines. The IA department consists of five functions:

- Gaming compliance, which consists of audits required by regulators per jurisdiction
- Sarbanes-Oxley, a team that performs all testing for management nine months during the year
- Financial and operational audits, those that cover the standard array of risks and controls
- IT audits, which combine internal resources and a third-party provider
- Construction and real estate audits, an increasingly important area given the company's investments in new properties over the next three years

The auditors in IT and construction audit areas report directly to Rudloff, while the other areas report to the assistant vice president who has daily responsibilities for managing compliance, financial, operational and Sarbanes-Oxley audits. Rudloff reports to the audit committee and the board of directors, with dotted-line reporting to the president and CFO of MGM. The IA function uses TeamMate for work paper documentation, scheduling, time reporting and project monitoring, and is in the midst of rolling out enterprise risk assessment as part of that tool. The IA team also is expanding its data analysis and inquiry functionality in ACL.

### Keeping up with auditor turnover

Turnover in the MGM IA function is high. “Over the past two years, we placed 24 people from IA into operational and finance positions in the company,” says Rudloff. “When I joined in 2003, one of my strategic initiatives was to establish more effective career development to help us build the skills we need to move auditors into the company. When I was hired, I told management that if, one year later, 50 percent of the IA team remained, I would have failed.”

Staffing is a constant challenge for Rudloff for many reasons. First, the marketplace is tight. While Las Vegas is a rapidly growing city, accountants and auditors are not primarily responsible for that growth. Second, MGM is competing with the Big 4 firms, three of which have offices in town and all of which are looking for additional resources. Additionally, companies adhering to Sarbanes-Oxley regulations are looking for IA talent to aid with compliance efforts. “We have taken an already thin pool of talent and spread it over many organizations with different demands and expectations,” Rudloff says. “To compete, we have to differentiate our company as an attractive place to work.”

Rudloff is seeking highly educated auditors with diverse backgrounds and experiences that extend beyond the gaming industry. “MGM is a people-oriented business, so interpersonal skills are important,” he says. “In Las Vegas, we earn our money by entertaining our customers in the friendliest way possible. Likewise, our IA team has to develop positive relationships in all different parts of the business and never allow ourselves to become cold or detached. Company culture matters because these auditors eventually move into the business; therefore, we tend to look more broadly at skill sets.”

### Three types of risks

The types of risk that the IA team identifies and manages at MGM are:

- **Hazard risk** – The risk associated with negative occurrences such as issues surrounding regulatory noncompliance, fraud or waste, significant accounting errors or damage to the company’s image.
- **Uncertainty** – The risk of failing to meet the expectations of shareholders, employees, suppliers, regulators, creditors, analysts or others. This risk can be affected by hazard and opportunity risk.
- **Opportunity risk** – The risk associated with failing to identify and leverage opportunities. This can include not pursuing a viable growth strategy, following a flawed growth strategy, or not managing opportunities as effectively as anticipated.

“The biggest risk for us is change,” says Rudloff. “When I joined the company, we had 12 properties; through acquisitions, MGM has doubled its properties and is expanding across the globe. There are significant risks in blending organizations.”

As MGM begins to develop and sell real estate – a new product profile for the company – entirely new risks emerge. Additionally, protecting the company from a regulatory point of view is a challenge for the IA team.

“The audit mission and vision is to provide assurance to management that, as they sign their names on certifications, or as they are about to sell or buy properties, to protect the company’s interest,” says Rudloff. “We are proactive in inserting ourselves in the process to protect our assets and in developing talent for the future of the company.”

### Enterprise risk assessment

Rudloff’s vision for MGM is based on an inverted pyramid model, with risk assessment being the bottom tier, risk management as the middle layer, and enterprise risk management as the top layer. “With regard to enterprise risk management, that is the vision we intend to reach and we still have a way to go, but at least at this point we are conducting enterprise risk assessment, which is key,” he says. “We can’t be everywhere doing everything, but we view the organization holistically and we examine specific components and risks as part of the big picture.”

According to Rudloff, the enterprise risk assessment process is straightforward and is built on a series of annual interviews that include senior management, such as the chairman, the chief financial officer and the audit committee. “We try to focus on areas of the company that have suboptimum audit results,” Rudloff says. “We also try to pay attention to the areas that were not audited the previous year, so we talk to everyone on a two-year cycle. The interviews are somewhat structured but also flexible, and tend to take on a life of their own.” Soon, Rudloff says, he will move the team to conducting facilitated sessions.

Performance feedback is obtained through customer surveys and informally through conversations that auditors engage in through the course of the year. The actual IA plan is measured by how nimble and adaptable it is. “We have never finished an audit plan, and that is a sign of success,” Rudloff says. “I have been an audit director since 1986, and I know from experience that once the year starts, things begin to change and that means the work the IA team is doing has to change as well. You cannot necessarily measure yourself against what you planned to do at the beginning of the year.”

## Supporting an ethical business environment

MGM is a world-class organization and, clearly, governance plays an important role for Rudloff. “We have been asked to support and even improve MGM’s corporate code of ethics, code of conduct and conflict of interest policies,” he says. “As we identify new and emerging risks for MGM, we are in the position to frame different points of view from a governance standpoint. I am fortunate that less than one year after I joined the company a new audit committee chairperson was appointed and brought in a fresh dynamic – he demands more from IA and from management in terms of communication and disclosure.”

The most significant challenge going forward for Rudloff will be staffing and moving people to other parts of the organization, ensuring an ever-widening pool of resources for MGM. “To achieve this, we will be spending much more of our time recruiting,” he says. “Fifteen percent of our total IA positions are currently open and have been for more than two years. Without a full complement of staff, we cannot reach all of our goals.”

Keeping up with the rapid pace of change at MGM and in the gaming industry as a whole is the second major challenge Rudloff and his team will face. “As we move into different parts of the world and into a wider range of business arrangements, the IA function will have to be diligent about keeping abreast of new business activities, risks and opportunities,” Rudloff says. “As we expand, we reallocate resources, and we have to make sure we are dedicating the right resources to the right tasks.”

The third challenge is complying with regulatory changes, guaranteeing that management and the organization are protected from violations, fines or sanctions. Rudloff says, “To do this, we will be helping to design and establish the most effective processes, controls and systems up front, rather than letting management know what went wrong after the fact.”



# NASD

## AN EMPHASIS ON ASSURANCE: INTERNAL AUDITING AT NASD

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Under federal law, virtually every securities firm conducting business within the United States is a member of NASD, a private, not-for-profit organization. As of January 2007, nearly 5,100 brokerage firms, with almost 170,000 branch offices and more than 650,000 registered securities representatives in the United States, come under the jurisdiction of NASD.

Until recently, NASD also owned NASDAQ. In 2000, NASD began selling off its interest in NASDAQ to concentrate solely on its core mission, which is ensuring market integrity and investor confidence, a mission that has been underway for almost 70 years. NASD's divestiture of NASDAQ became final in 2006.

NASD licenses individuals and admits firms to the securities industry, writes rules to govern their behavior, examines them for regulatory compliance, and disciplines those who violate the rules. In addition, the organization oversees and regulates trading in equities, corporate bonds, securities, futures and options. NASD also provides education to industry professionals and investors, and operates the world's largest securities dispute resolution forum, using arbitration and mediation programs to process more than 4,600 arbitration claims and nearly 1,000 mediation claims a year. With a staff of nearly 2,500 and an annual budget of more than \$500 million, NASD is a world leader in capital markets regulation.

Dan Shook, NASD's senior vice president of internal audit (IA), who reports to the audit committee and the chief administrative officer, has more than 35 years of IA experience. Mike Hourigan, the group's vice president and assistant general auditor, has 21 years of internal auditing experience, and is one of three vice presidents who report to Shook. Shook oversees a group of professional auditors who are divided into three different teams, supplemented by an allocation for contract staff. One team is focused on information systems audits. Two are focused on business areas: operational, financial, regulatory and compliance audits. Within those business audit teams, the IA function has two specialists – an attorney with regulatory experience, who keeps the team abreast of all legal issues and developments, working with the other attorneys in NASD; and a programmer analyst, who executes the team's Computer Assisted Audit Tools and Techniques (CAATs), and develops and administers the group's audit management and work paper systems.

### Automation

The in-house-developed audit management system, NAMIS (NASD Audit Management Information System), assists the team in managing the audit function. "NAMIS has many functions, including managing the audit process and projects from cradle to grave," says Shook. "We use NAMIS to identify, define and manage the universe of business process entities that we might audit. By cataloging all auditable entities in NAMIS, and assigning all general ledger accounts, applications systems, organizational units, and NASD and SEC Rules, we make certain that we consider all activities of the organization in doing our annual and strategic planning. Our risk assessment process then helps us to determine the frequency with which we conduct different audits, with the highest risk audits being performed every year or two, medium and moderate risk audits on a three- or four-year cycle, and the lowest risk audits not included in the four-year planning cycle."

The team also uses NAMIS to manage the annual audit schedule and individual audit engagements. NAMIS assists the management team in allocating staff resources, tracking progress, capturing time, and monitoring budgets and deadlines. The management system links with the automated work paper application (also developed in-house) to set up the individual audit project work paper folders. To support IA's role in NASD's Sarbanes-Oxley Section 404 reporting, IA has linked the

automated work papers to the Protiviti-supplied Sarbanes-Oxley technology used by NASD's Finance department. When audits are completed, NAMIS automatically posts issues from audit reports to the system, facilitates issue updates by the accountable business staff, tracks issues to closure, and provides reports on issue status to management and the audit committee.

"In all of this, we have tried to remove as much of the administrative work from the audit process as possible," says Shook. "We think that this level of automation, and the tailoring of the automation to our approach, is unique."

## Audit staff management

The IA team has experienced relatively low turnover, stemming from the fact that NASD treats its employees well, provides strong HR benefits, and fosters an independent, professional culture that people are glad to be a part of.

Hourigan, who leads one of the two business area audit teams, says that there are several important aspects to the overall strategy of maintaining an effective IA team:

- Strong training programs
- Process improvement teams
- Internal transfers, which bring people with relevant business experience into the IA team
- A focus on hiring individuals with audit and securities experience, and hiring specialists as necessary
- Co-sourcing relationships with outside providers to gain technical skills, flexibility and resources at times of peak demand, and to cover staff vacancies, when they do occur

"We have a strong team of diverse and seasoned professionals," Hourigan says. "To enhance interpersonal skills as auditors, staff members participate annually in a role-play game. In groups of about six, using random combinations of situations and personalities, staff members hone their skills for reacting to complex, changing situations. More significantly, each staff member also obtains technical training related to their own development needs or related to specific upcoming audits."

Shook adds, "We also target specific training that we need as a group, such as bringing professionals in to help enhance our writing skills. Also, in 2006, for the first time, one of our staff qualified for the NASD Accelerated Development Program that identifies high performers and future leaders, and puts them through a special 18-month developmental program."

## Risk-based auditing

NASD uses a modified balanced scorecard approach to auditing that targets four specific areas:

1. **Providing risk-based audit plan coverage.** The IA team conducts its audit planning over a four-year horizon, emphasizing higher risk processes and modifying the audit universe when necessary. IA involves senior management in the IA team's risk assessment process, through structured interviews and informal discussions. The methodology and management involvement that the IA team uses to build the four-year strategic audit plan also supports IA's resource allocation and budget requests, resulting in support of the IA budget by management and approval by the audit committee. Each year of the four-year plan covers 30 to 40 percent of the audit risk presented. The team also has a one-year planning horizon that outlines specific audits that must be performed, with corresponding fieldwork completion and report issuance target dates that coincide with audit committee meetings. During each year, the team makes changes to the audit plan as issues emerge that change the organization's risk profile. The goal is to issue audit reports, which include management's responses, within 30 days of completing fieldwork. In addition, Shook is the staff liaison to the audit committee, and provides supporting materials, such as minutes, agendas, meeting schedules and all pre-meeting materials. He also facilitates the committee's annual self-assessment process.

2. **Adding value to the organization.** The IA function uses process-improvement teams to identify opportunities to streamline and enhance audit processes, including refining work papers and audit follow-up processes, and implementing continuous auditing (a 2007 goal). Using a tool developed by the Audit Directors Roundtable, Calibrating Audit Stakeholder Expectation (CASE), the IA team gathered feedback from several groups regarding audit priorities and IA's performance against those priorities. This is a 360-degree evaluation with the audit committee, senior management, line management and the IA team itself completing a survey that ranks each of 35 audit process attributes. The results of this effort will serve as input to process-improvement efforts.
3. **Supporting key initiatives.** For example, the IA team developed reviews and testing processes related to Sarbanes-Oxley Section 404 reporting. IA has built these tests into the annual audit plan by performing the tests as part of scheduled full-scope audits and allocating resources to limited-scope reviews of Sarbanes-Oxley key controls for audits that are not in that year's audit plan. In addition, each year IA performs four to eight development reviews, where IA partners with the development team as part of systems- and process-development efforts in the key business areas.
4. **Managing the IA budget.** The target is to be within plus or minus five percent of the IA function's budget each year. At an individual staff level, this means managing audits to planned resource hours and completion dates.

## Sarbanes-Oxley

As a not-for-profit organization, NASD implemented Sarbanes-Oxley compliance on a voluntary basis, one of the first nonprofits to do so. The company's audit committee and executive management team believed that it was important for NASD, as a securities industry regulator, to set an example of good corporate governance. As part of its Sarbanes-Oxley compliance, NASD undertook Section 404 reporting in its 2005 annual report. IA performed two primary functions in support of this effort:

- While the NASD Finance Department led the Sarbanes-Oxley 404 implementation, IA contributed by evaluating the implementation process, monitoring project milestones, helping management define controls and develop self-assessment tests, and ensuring consistent high-quality documentation.
- The IA team conducted tests of the effectiveness of controls and of management's performance of self-assessment tests.

In 2006, because the Finance department was already responsible for Sarbanes-Oxley 404 reporting, there was no need to transition responsibility to finance, as many internal audit teams had to do. Therefore, the IA team's project monitoring was more limited than in 2005. "Our primary efforts were in the performance of effectiveness testing, remediation testing and year-end refresh testing," says Hourigan. "In 2007 and beyond, we expect our efforts to continue to be focused on effectiveness testing. We will also have input on management's reaction to new guidance from the SEC and PCAOB."

The IA team has played a significant role in evaluating the tone at the top and other key entity level controls, as part of its annual Section 404 testing processes. "We also conduct a periodic full-scope audit of corporate governance activities, such as compliance with NASD's code of conduct, the board of directors' charter, the use of budget, etc.," Shook says. "Senior management has provided excellent support for our team, which truly supports the tone at the top and allows us to contribute to sound corporate governance."

## Providing assurance into the future

Both Shook and Hourigan cite the need to stay abreast of the changing regulatory landscape for the IA team to continue to add value to NASD into the future. With the recent regulatory merger between NASD and NYSE, the IA team's risk-based auditing approach will prove to be essential in identifying and managing changes that emerge from that consolidation.

“Over the last several years, we have upsized, downsized and right-sized the IA team at NASD, depending on the shifts in organizational structure and strategic focus. We are here to provide assurance related to the internal control environment, rather than to fill a role of consultant or advisor. I'm comfortable that our basic approach and focus can keep us in line and in tune with the organization as it evolves,” says Shook.

## PARTNERING FOR BUSINESS EXCELLENCE: INTERNAL AUDIT SERVICES AT RBC

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Royal Bank of Canada and its subsidiaries operate under the master brand name, RBC Financial Group (RBC). RBC is Canada's largest bank and one of North America's leading diversified financial services companies. RBC provides personal and commercial banking, wealth management services, insurance, corporate and investment banking and transaction processing services on a global basis. Approximately 70,000 people worldwide serve more than 14 million personal, business and public sector clients throughout offices in North America and 34 countries around the world.

In Canada, RBC has strong market positions in all of its businesses: It is first or second in most retail products related to personal and business banking; first in full-service brokerage operations related to wealth management; first as a mutual fund provider among Canadian banks; and second among self-directed brokers. Operations include 1,443 branches, 4,232 automated banking machines, and assets of \$537 billion.

Francine Blackburn has been the bank's executive vice president and chief internal auditor for seven years. Laura Simeoni, who has been a professional development consultant for approximately 20 years, including five years as audit trainer and consultant to the internal audit function at RBC, has been director of professional audit standards at the bank for two years.

RBC's Internal Audit Services (IAS) department consists of 250 auditors. Blackburn reports functionally to the audit committee and administratively to the chief operating officer. The audit staff, located primarily in Toronto, and with some staff in North Carolina and London, help contribute to the management risks and controls related to RBC's many business lines.

### Audit mission and purpose

The mission of IAS is to provide independent, objective risk assessment and evaluation of the adequacy and effectiveness of risk management practices, internal controls and corporate governance processes in all areas of RBC Financial Group. The auditors work with management to achieve business objectives by ensuring appropriate remedial action takes place to improve operations, while remaining objective and independent. Key stakeholders include the board of directors, shareholders, auditors, regulators and senior management.

"Our purpose is to provide assurance services for the benefit of key stakeholders and to perform audits for RBC leadership and senior management, as well as regulators," says Blackburn. There are two key areas of responsibility that Blackburn and her auditors adhere to:

- Providing first-class audit services and expert advice on risk management practices, internal control and corporate governance processes.
- Offering consulting and advisory services or carrying out other special tasks that help evaluate and improve the effectiveness of risk management, control and governance processes at RBC.

To accomplish the mission, IAS' priorities are centered on four themes:

1. **Have a capable, highly motivated team.** To ensure a highly skilled and motivated audit function, IAS implements effective, leading-edge approaches to recruitment, placement and succession planning, as well as personal and professional growth and the development of leadership qualities. "One way that we ensure that we have skilled and motivated auditors is through our training programs, such as privacy training in 2007, a critical issue for many regulators around the world,"

says Blackburn. Another 2007 priority is to establish a plan to complement the IAS staff with individuals who have professional audit designations and experience, and to implement an internal and external mentoring program.

2. **Use superior audit practices.** IAS adheres to The IIA standards, as well as the RBC code of conduct, which is supplemented by its own code of conduct for auditors. “We follow Generally Accepted Auditing Standards and standards established by the Institute of Internal Auditors,” says Blackburn. “We also maintain a quality assurance review program to evaluate the operations of IAS.” She and her team use leading-edge and best-practice approaches in risk-based audit planning and execution, including regulatory compliance, continuous auditing and CAATs.
3. **Forge strong partner relationships.** To be recognized as a valued business partner, IAS engages in proactive, open communication, timely consultative advice for mitigating risks, and accurate reporting. The “convergence initiative” at RBC is designed to reduce duplication, so that a business unit is not assessed multiple times throughout the year and a coordinated approach for risk management and evaluation exists across the company. This requires a joint effort with RBC’s Group Risk Management, which has overall responsibility for Operational Risk; the Global Technology and Operations group, which manages Risk and Control assessments; and IAS, which includes the group responsible for Sarbanes-Oxley.
4. **Create audit efficiencies.** During 2007, IAS is completing a review of core audit programs used on every audit (such as anti-money laundering, privacy, business continuity and end-user computing) to look for ways to improve efficiencies. “We track the length of time it takes to complete each audit to improve our efficiency and effectiveness,” says Blackburn. “We are striving to increase the transparency of the time and cost associated with each audit.” Blackburn says she and her team also intend to become more effective and targeted in their use of CAATs. “We want to make sure we produce quality instead of just quantity,” she says.

## Auditors who drive success

The target for IAS is to maintain a turnover that falls within 20 percent; currently, turnover is 14 percent, but last year it rose to 30 percent, primarily through transfers to other areas of the bank. “We went through major changes in the company in 2006,” Blackburn says. “Currently, we use a monthly pipeline report to maintain a reading of our existing complement, as well as our job offers, transfers and what we need to achieve to manage resources and planning. If we are under-resourced, then we are, in effect, eroding our cushion of 11 percent for unplanned audit work.”

Across the bank, including in IAS, half of any employee’s performance management appraisal is related to the following key behaviors:

- Put client first
- Collaborate as partners
- Develop people
- Act on our accountabilities
- Make decisions faster
- Prioritize for greatest impact

“In addition to these six behaviors, twice a year auditors update their Key Behaviors Worksheet that has been customized for IAS,” Simeoni says. This worksheet is used during performance reviews with people managers. She and Blackburn provide examples for expected behaviors, which are then used to make assessments. Ratings help determine compensation and bonuses.

“We continually reevaluate the skill sets of auditors we need,” Blackburn notes. “We need more auditors with professional audit backgrounds.”

## Corporate governance compliance

While 2006 was the first year for RBC as Sarbanes-Oxley 404 registrants, in 2005, IAS led a “dry run” of 404 compliance efforts. “At the time, there was a specific team dedicated to Sarbanes-Oxley work because I did not want to undermine our regular audit work,” Blackburn says. “We have since fully integrated Sarbanes-Oxley work throughout the audit groups. For example, the capital markets audit group is responsible for carrying out the full operating effectiveness testing, in addition to their regular audit work.” In Canada, the Basel II requirements are in effect, and IAS must provide an audit opinion on RBC’s internal controls to ensure compliance with those regulations.

Blackburn says she has been conducting corporate governance audits for many years, which have given rise to a wide range of assessment activities in RBC. “Over the years, we reviewed the adequacy of corporate governance at both the RBC and subsidiary levels,” she says. “Focusing on corporate governance has been in my mandate for the past seven years. We have performed several audits in this area in Canada and the United States.”

IAS has developed targeted regulatory compliance training for business auditors. The goal is to make sure that business auditors have a better understanding of regulatory compliance requirements so they can execute audit procedures and ensure compliance.

## Performance measurement

The Balanced Scorecard process has been in place for several years at RBC; it is updated annually after plans and goals are set for each year. “We take our four priorities – have a capable, highly motivated team; use superior audit practices; forge strong partner relationships; and create audit efficiencies – and outline key success factors under each,” Blackburn says. “One aspect of our scorecard objective is for 75 percent of auditors to have 10 years of business experience, 60 percent to have a minimum of three years audit experience, and all audit staff to have an average of 50 hours of training annually – a metric we always exceed.”

Progress against the audit plan on a quarterly basis and any important changes are reported to the audit committee, along with quarterly progress reports. “We meet with external auditors and regulators on a quarterly basis to review all IAS activities, talk about plans for the remainder of the year, and adjust for any requests they may have,” Blackburn says. “In addition, we meet with senior management of various business groups on a quarterly basis to discuss audit results, issues and plans.”

## Continuous auditing

In addition to the traditional audit schedule, on a quarterly basis IAS issues a report on every auditable unit within RBC, producing a streamlined, short-form report to senior management, as well as a more detailed report outlining key risk indicators and underlying data to middle management. “This is our unique continuous auditing approach,” says Blackburn. “We make extensive use of technology to extract data and assess our key controls; the approach is highly disciplined. For every element of an auditable unit, we look at an internal control summary to determine the key issues that we must keep an eye on. With this continuous auditing, we can determine the control work that must be accomplished between traditional audits. We also review other factors, such as the resolution rate of audit issues.” Currently, 20,000 hours per year are dedicated to continuous audits.

## Looking ahead

“We are a key contributor on an initiative to achieve an integrated approach in reviewing risk and controls, as there is currently a multiplicity of risks and control assessment activities across the bank,” Blackburn says. “Another area of high focus deals with how we balance a risk-based audit approach with certain regulatory expectations of internal audit. For example, in the United States, there are certain audits that regulators would expect to be done on an annual basis, while from a risk perspective, we would audit on a longer cycle.”

## RBS AUDITING: “FIRST-CLASS TEAM, FIRST-CLASS PRODUCT, FIRST-CLASS SERVICE.”

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*Scotland’s largest bank developed a long-term vision for improvement that is simple yet comprehensive.*

The Royal Bank of Scotland Group (RBS Group) is one of the world’s leading financial services companies, providing a range of retail and corporate banking, financial markets, consumer finance, insurance, and wealth management services. RBS Group operates in Europe, the United States and Asia Pacific, serving more than 36 million personal banking customers worldwide and employing more than 140,000 people. In addition to offering a full range of banking services under The Royal Bank of Scotland and NatWest brands, RBS Group also includes Citizens Financial Group, Ulster Bank, Coutts Group, Direct Line and Churchill.

RBS is structured by divisions, which include:

- Corporate Markets, which consists of two groups: Global Banking & Markets, a leading banking partner to major corporations and financial and government institutions around the world; and U.K. Corporate Banking, the largest provider of banking, finance and risk management services to United Kingdom corporate and commercial customers.
- RBS Insurance, the second largest general insurer in the United Kingdom. Its brands include Direct Line, Churchill and Green Flag.
- Citizens, which provides retail and corporate banking services through the Citizens and Charter One brands in 13 states throughout the Northeast and Midwest regions of the United States.
- Manufacturing is the “engine room” of the RBS Group, supplying processing, telephony, IT, property, purchasing and security to the group’s business divisions.
- Retail Markets provides a broad range of retail services across different brands to personal and small business customers. It has four distinct business areas: Consumer Banking, Business Banking, Cards and Wealth Management. The most well-known brands are RBS and NatWest in the United Kingdom, and the Coutts brand, which operates across the United Kingdom, continental Europe and Asia Pacific.
- Group Functions, which consists of risk management, finance, human resources, legal and audit.

Sally Wharton has been the head of audit for corporate markets at RBS since January 2005. Her career has been focused on internal audit for more than 18 years, first at Chase Manhattan Bank and then at RBS. Kevin Simons, who reports to the audit committee, finance director and CEO, is the global head of group internal audit, with five direct reports working for him. The audit team is structured along the same lines as the bank, with audit heads overseeing each division. The audit team consists of approximately 360 auditors based in the United Kingdom, United States and Hong Kong. Sixty-five members of the team cover corporate markets.

Once per year, Wharton, Simons and the other audit heads spend a full day with the audit committee discussing the audit plan in detail, explaining the risks emerging throughout RBS and the audit team’s intended approach for auditing those risks. “The purpose is to give the audit committee comfort around the audit plan,” she says.

## A blended staffing strategy

Many auditors join Group Internal Audit (GIA) as a first step on their career path with RBS. The bank has a graduate program within Group Finance, where graduates spend a total of three years in three different functions in the bank, including audit. The team also consists of career auditors. “We have a mixture of years of experience and background, giving us a diverse group of auditors,” says Wharton. “About 35 percent of our team has more than 10 years’ experience in audit and in RBS, and 35 percent has less than two years. In terms of backgrounds, different areas of expertise lend themselves to different divisions within RBS. In corporate markets we have auditors with specific expertise around market risk and trading, operations credit and regulatory risk. We also try to attract experienced corporate bankers on secondment to work with the function.”

While the staffing strategy may be a blended approach, the recruitment process is stringent. It involves competency-based interviewing and a search for both technical and soft skills. “In addition to the full range of technical auditing capabilities and softer skills, such as the ability to work well in a team environment, we are looking for auditors who can write well,” says Wharton. “Communication is so important and auditors who have the ability to write accurate, effective reports are in short supply. Part of our recruitment [process] includes a case study review, after which the auditor is expected to write a presentation based on what he or she learned from the case study. It is a test of comprehension, writing talent and presentation abilities.”

## A vision for improvement

In 2003, the senior leadership team created a long-term vision for the future of the audit function: “First-class team, first-class product, first-class service.”

**First-class team:** “We want to make sure we recruit and develop the best team we can,” Wharton says. “For example, we created a secondment policy, taking professionals from the bank on short-term audit assignments, as well as sending our auditors out on secondments throughout the organization. This is a tremendous way to facilitate skills transfer. We also created a mentoring plan and trained over 60 mentors. Additionally, the audit team makes use of bankwide training and assessment opportunities.

“We have invested significantly in training and career development,” Wharton adds. “GIA has also hired their own dedicated trainer and part-time coach to help develop a coaching culture across the department and to work on development of high-potential individuals.”

**First-class product:** To deliver a first-class audit product, the audit group has established a QA process and team to review individual audits and specific elements of the audit process, including planning and reporting methodology and people plans. In addition, every three years, an independent review is performed of the function, looking at its organization and quality of the work performed by GIA. The function also has employed a writing coach to help improve the quality and consistency of audit reports.

**First-class service:** “We want to respond to our stakeholders’ needs and expectations,” says Wharton. “To gather feedback, we send out annual requests for feedback to determine how and where we are adding value. GIA has an operations and development team which has responsibility for tracking these improvement initiatives taking place within the audit function.”

## Corporate governance

The auditors at RBS worked closely with management and external auditors to help develop an approach to Sarbanes-Oxley compliance. The Sarbanes-Oxley program for the bank is overseen by a former head of audit. “Some banks’ IA teams hired many extra auditors to conduct Sarbanes-Oxley testing and others perform absolutely no work related to Sarbanes-Oxley at all,” says Wharton. “We are somewhere in the middle. We collaborate with our external auditors to make sure the documentation and testing is adequate. We share our audit plans with the external auditors and have established an approach with them in which they can place reliance on the work we do, which helps them meet their compliance needs. We have looked for ways to gain synergies out of the risk-based audit plan we run and the requirements of Sarbanes-Oxley. In short, we have tried to be pragmatic in our approach.”

## Key challenges

“Continual improvement is one of the function’s operating principles and the team is always looking out for ways to improve efficiency of working practices, and the quality of the work we do,” says Wharton. “This remains a key priority for us as we look into 2007.

“Recruitment and retention of our people also remains a key area of focus,” she adds. “The employee opinion survey provides audit management with feedback on the satisfaction and engagement of staff. Time and effort is invested in improving the areas with which the team is less than satisfied. There is a very competitive recruitment market and RBS has to work hard to attract and keep its people.”



## KEEPING THE LIGHTS BURNING: THE IA TEAM AT PHILIPS – CARETAKER OF A STRONG RISK MANAGEMENT AND CONTROL ENVIRONMENT

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Headquartered in the Netherlands, Royal Philips (Philips) is a multinational organization with 122,000 employees and €27 billion in revenue. Philips is currently transforming its portfolio and positioning in the marketplace. As a leading electronics company, it is now venturing into healthcare, lifestyle and lighting. With more than 80,000 patents, Philips ranks number 48 in worldwide brand value, according to *BusinessWeek*. In total, Philips operates in more than 150 countries, with sales outlets and manufacturing sites in 28 countries. Its operations include four product divisions.

The first product division is Lighting, with 47,750 people worldwide, sales and service organizations in 60 countries, and manufacturing operations in the Netherlands, Belgium, France, Germany, the United Kingdom, Poland, the United States, Mexico, Brazil, India, Indonesia, Thailand, China and South Korea.

Medical Systems is the second product division, with approximately 33,000 people around the globe specializing in diagnostic imaging systems, customer services and clinical solutions. More than 63 countries operate sales and service organizations for Medical Systems, and manufacturing operations include the Netherlands, Germany, Finland, Israel and the United States.

Consumer Electronics is the third product division, employing about 14,500 people internationally and with a focus on connected displays, home entertainment networks and mobile infotainment. This division has sales and service organizations in 50 countries with manufacturing operations in Belgium, France, Hungary, Mexico, Argentina, Brazil, India and China.

Finally, the Domestic Appliances and Personal Care division employs approximately 11,000 people worldwide, with sales and service organizations in 60 countries and manufacturing operations in the Netherlands, Austria, Poland, the United States, Brazil, China and Singapore.

Luvic Janssen has been executive vice president and head of internal audit (IA) for five years, and with Philips for 25 years in a variety of roles in finance and auditing. The IA department has approximately 90 auditors in five locations around the world – the United States, the Netherlands, Poland, China and India. The department is organized according to the same governance structure as the corporation, with an auditor assigned to each product division and dedicated teams reporting to those “product division” auditors. All product division auditors report to Janssen, who in turn has a direct reporting line to the CEO, and a functional reporting line to the head of the audit committee of the supervisory board.

### A talented IA team

The IA team at Philips is a talent pool for the organization, with a high rotation – between 20 percent to 25 percent per year. “This is a big challenge for us,” Janssen says. “The internal job market is attracted to our auditors, so transferring them out of the function is not a problem; however, attracting and retaining new [talent] from within the company is a challenge.”

The development strategy at Philips is centered on nurturing talent within the organization. Yet today, as Janssen points out, “For every four persons we attract, we get one from the inside of the company and three from outside. Without compromising on the quality of our staff, we want to change that and get more people from inside – a 50-50 balance.”

Janssen takes a broad view of audit because his intention is to support management as they face real business risks. To accomplish this, he requires talented auditors, and not just those with financial audit experience, but business professionals with a full spectrum of skills. “We can always teach them how to perform audits,” he says. “We need individuals with business instinct who can create more value in audit reports.”

Janssen seeks divergent teams with the right mix of skill sets – finance, business acumen, information technology and supply chain management – although he recognizes that it is difficult to have all those skills present in one IA function. This is why he recently embarked on a guest auditor program, where he invites experienced people in from the business for a particular audit. Janssen also entered into a partnership with Ernst & Young, who provides Philips with audit expertise in niche areas, such as treasury.

## The eyes and ears of the company

“One of our strategic goals is to be the eyes and ears of the audit committee and supervisory board,” Janssen says. “We want to proactively identify key risks and control weaknesses. Our goal is to deliver value-added recommendations, not just in financial and compliance auditing, but in audits related to strategic business risks and related controls – the management issues that must be addressed.”

In 2006, this was a significant challenge, as Philips, being a foreign registrant under U.S. corporate governance standards, had to comply with Sarbanes-Oxley Section 404 for the first time. The IA team has played an instrumental role in ensuring that Philips reached Section 404 compliance, executing controls testing for management and providing support and advice. “It has taken our attention away from auditing other business risks,” Janssen says. “It also undermined our independence. It has been a logical short-term reaction from management. They had limited time to comply with a new law, which due to its formalistic nature, was very time-consuming to implement. Going forward, I want to position IA much more as a business advisor that facilitates positive change rather than a policeman. This year, we will move away [from] the role of the executioner for [Sarbanes-Oxley] 404 compliance and become primarily a reviewer and challenger of the process.”

## Measuring performance

Performance measurement is a structured process at Philips. Janssen has a mandate that is approved annually by the audit committee of the Philips supervisory board. This mandate is delivered in a charter, and it outlines the management agenda for the IA team. “We agree [on] our annual audit plan and establish a business-balanced scorecard to monitor our actual performance against promises made. After each audit, we send out a customer satisfaction survey and we review satisfaction from the point of view of key stakeholders,” he says. “We have just introduced a quality issuance process after every audit to gather feedback, and we conduct annual peer assessments and employee engagement surveys to measure employee morale and ultimately, improve management performance.”

During this process, IA also measures the cycle time of the audits, as well as training hours.

## Building relationships

While Janssen always seeks to add more value in the role, the IA department at Philips is firmly established and interacts with management through a network of 50 audit committees at several levels, and in various business units. In addition to performing audit investigations on the quality of the internal controls, the IA function adds value by conducting strategic risk-based workshops with business management.

“In addition to our audits, we perform the kind of service that is not directly related to audit opinions,” Janssen says. “We focus on high-risk areas by performing risk assessments, outlining issues with management, conducting analyses of the business, and then bringing together the findings and calibrating and prioritizing risk for them. This provides management a total overview of the risks they are facing. We then help them understand the actions they can take to remove those risks, which they highly appreciate. This helps us to build a better audit plan.”

After many years of reorganization, Philips is now focusing on growth, both organically and through acquisitions. “As IA, we want to support management in realizing these growth ambitions. Therefore, we will direct much of our 2007 audit time to high-risk areas related to the Philips’ strategy. Acquisitions, historically, have a high risk of failure due to bad integration of processes, systems and people,” Janssen says. “To support the realization of our in-house growth ambitions, we pay specific attention to the effectiveness of new product introduction processes. The company is allocating resources to increase brand awareness. We are monitoring the effectiveness of those efforts and overseeing the management of these funds.”

## A clear vision

Janssen wants to make sure that he is implementing risk-based audit coverage that detects surprises early in the process. “The worst thing that can happen is when you miss the big fire, and you can only extinguish it to count the losses and manage the damage,” he says.

“My vision is clear – I want to see IA become a true breeding ground for talent. I envision people knocking on the door to get into the IA team, with full support from management,” Janssen says. “I want our team to be viewed as a change agent and a strategic advisor for Philips.”



**SHINSEI BANK**

## REFURBISHING INTERNAL AUDIT'S IMAGE AT SHINSEI BANK

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Shinsei Bank was founded in 1952 as Long-Term Credit Bank of Japan, which had a government permission on the issuance of many long-term debt securities along with two other long-term credit banks. The government nationalized the bank in 1998, and after proposed mergers with domestic banks, the company was sold to an international group led by U.S.-based Ripplewood Holdings in March 2000, marking the first time in history that a Japanese bank came under foreign control. Ripplewood invited Masamoto Yashiro, a former head of Citibank in Japan, to restructure the bank and renamed it “Shinsei Bank” – which translates as “Reborn Bank” – in June 2000 with new management and services.

The bank is headquartered in Chiyoda, Tokyo, Japan, with 42 outlet networks in Japan and subsidiaries, affiliates, or joint ventures in the United States, Taiwan, Korea, the United Kingdom and Germany. Shinsei Bank group employs approximately 5,000 professionals and focuses on three primary lines of business: institutional banking, retail banking, and consumer and commercial finance.

Naohiro Mouri is the general manager of the internal audit (IA) division of Shinsei Bank, overseeing about 60 auditors in both Shinsei Bank and its subsidiaries. His division performs audits that align with each of its businesses, leveraging IT and operational auditors to support those activities. A CIA and CPA, with a background primarily in IA and accounting, Mouri has held his position since November 2002, and reports to the bank's CEO and the chairman of the board audit committee.

### IA as HR

According to Mouri, many Japanese companies traditionally have approached IA in terms of a human resources strategy. “Historically, IA has been seen more or less as the final career position a professional will enter before retiring – a last stop prior to exit,” he says. “Those at the end of their careers will come to the IA team to rest before retirement. Also, IA has been seen as the ideal post for professionals who have been working in foreign subsidiaries, a place to reacquaint with the domestic business before reentering it – a sort of transition.” Mouri says this has changed dramatically in the past four to five years, especially with the advent of corporate governance regulations and a new awareness and scrutiny of internal controls.

“I am here to make changes,” he says. “My background includes audit work in Europe and the United States, where IA is seen as professional work performed by experienced and qualified people who independently evaluate the internal control environment of their organizations. This is what I am implementing here.”

Most of the auditors at Shinsei Bank come from a variety of business disciplines, not necessarily from external audit. As a result, they tend to have a deep understanding of the business, with hands-on experience in operations that give them a realistic perspective of how to design, implement and evaluate robust controls. “I am emphasizing that our auditors should look at controls and identify, analyze and report on the risks involved,” Mouri says. “Audit teams at Japanese financial institutions have evolved in the past five years, from inspectors to consultants. They are adopting a risk-based approach to IA, in which the auditors discuss risk with the business units and develop solutions to enhance controls.”

Because he draws on internal resources with on-hand business knowledge, turnover in his function is relatively high compared to his peers. To cope with the turnover, Mouri invites business unit staff as guest auditors and works closely with his peers in the compliance and risk control divisions. “We train them on the concept of controls and send them back to the bank’s business units to enhance their controls and advocate for the IA point of view,” he says. “Shinsei Bank views the IA function as the talent pool for the company, but also as the guardians of control. Management appreciates our work; we have frequent dialogue with business unit leaders.”

The most critical skill Mouri seeks in auditors is a true understanding of the risks inherent in the business, including operational, market, credit and accounting risks. He also looks for analytical ability and communication skills.

## Guardians of control

Since the management of the bank views its internal auditors as the guardians of control, Mouri sees his short-term goals as finding, analyzing, crystallizing and solving problems with internal controls throughout the bank. “We run a risk assessment every year,” he says. “We send our auditors to high-risk areas to begin with, and then we drill down to low-risk areas as time progresses. Since the entire organization has only 60 auditors (40 in Shinsei Bank and the others in the bank’s subsidiaries), we cannot look at each business unit in the audit universe on an annual basis.” The IA team reviews the business units on a three-year cycle, making certain to visit high-risk areas three times in three years, medium-risk areas twice in three years, and low-risk areas once every three years.

## Continuous audit

The long-term goals for the team consist of continuous auditing activities that include analyzing control breakdowns based on data acquired related to the bank’s systems, information network, control trends, trading environment, error rates, compliance issues and reporting mechanism. “We have various ways of capturing control breakdowns,” Mouri says. “When we see the breakdown trends emerging, we send in our IA troops to identify and solve them. This is a departure from a traditional approach; it is a more issues-focused, real-time, solutions-oriented approach that we call continuous auditing. My long-term goal is to combine continuous auditing with traditional audit activities.”

To measure the effectiveness of the IA team’s short- and long-term goals, audit customers rate the performance of each of the approximately 100 audits performed every year. The customer ratings describe the degree to which the auditors were helpful, clear and effective. Mouri uses the 100 customer ratings he receives each year as a tool to promote and improve the IA team. He also meets with division managers every quarter to discuss past audit issues and activities, as well as with the CEO and board audit committee chair every month. Finally, Mouri uses a 360-degree evaluation, asking each auditor to gather feedback from at least eight peers or auditees.

## Auditors and management

Mouri characterizes the relationship between auditors and management as love/hate. “They love us because we come in to do the health check, clean them up or tell them they are fine,” Mouri says. “On the other hand, they may not like us when we have to tell them something negative but true, for example, if they are not doing what they say they are doing.

“Management sees us as a necessity and they invite us to important meetings, so we get real-time information. They do not hide information from us. Our CEO is a strong believer in IA, as well as in honesty and integrity. He reads every audit report and cares about them, so the rest of management must also care.”

## Corporate governance

The Japanese government passed a law last year to abide by regulations similar to Sarbanes-Oxley (sometimes referred to as J-SOX). Japanese companies, Shinsei Bank included, are required to issue an internal controls report together with an audit report and financial statement by April 2009.

“The changes in the corporate governance code in Japan were designed primarily to enhance management responsibility and increase the power of the audit committee and corporate auditors,” Mouri says. “At Shinsei Bank, we have four audit committee members and all members are from outside the bank and demand a significant amount of information from me. Our corporate governance is strong from that respect.”

## The vision of a renewed IA function

Several challenges face Mouri and his IA function as they strive to implement world-class audit practices. The first critical challenge involves the auditors themselves. “Audit is done by people. So, there are turnovers I must expect,” Mouri says. “How do we train and grow the next generation of auditors? We will implement enhanced certification and training programs, as well as the guest auditor program that we currently run.”

Fortunately for Mouri, the IA talent pool within Japan has been growing for the past four or five years, thanks to the emergence of corporate governance awareness in the marketplace. Sittings for certified IA exams are increasing dramatically. Mouri, who translated the exam for the Japanese marketplace, said that there were only 120 participants in November 1999 and now, there are 2,200. “This means there is a bigger pool for us to draw from as we hire auditors in the future,” he says.

The second challenge stems from the shortage of financial auditors with IT skills in the bank. “Process without technology no longer exists,” Mouri says. “We have a lack of audit resources that possess business and systems knowledge. There is a high expectation for incoming and existing auditors to learn about IT systems which, again, will involve training and certification.”

The most difficult challenge surrounds the expectation of the audit customer. As Mouri and his team move inexorably toward continuous auditing mode, the perspective of the audit client must adapt. “They will have to cooperate with us, providing more information and at the same time facing more scrutiny,” Mouri says. “Through a continual dialogue with business units, we are changing the conception of auditors. We want our audit customers to look at us as the guardian, the doctor of internal controls. Yet, as the doctor, we not only have the responsibility to identify the issues, but also to fix them.”

Mouri recently was nominated as secretary of the global executive committee of the Institute of Internal Auditors (IIA), the first Asian to be nominated to this position in The IIA’s history. As such, Mouri is asking his auditors to perform more community work, as well as to help his organization’s sales team respond more effectively to Shinsei Bank’s customers.

Many Japanese financial institutions are trying to revamp their IA activities, but they remain in inspection mode. Since Shinsei Bank’s sales people are more conversant in internal controls knowledge – due in no small part to the efforts of Mouri and his team – they can take these ideas to the bank’s customers, showing them how to restructure their organizations and establish workflow for standardized audit processes.

“We are spreading the word,” Mouri says. “Our sales teams appreciate these efforts. When I meet with the bank’s customers, often the CFO or CEO, our sales colleagues will join and listen to my presentation. They are impressed.”



**SIGMA-ALDRICH**

## SIGMA-ALDRICH: A COLLABORATIVE APPROACH TO INTERNAL AUDITING

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*The IA team is dedicated to helping the company build a strong internal control environment with innovative initiatives and a completely reengineered approach to Sarbanes-Oxley compliance.*

Sigma-Aldrich is a global life science and technology company that delivers biochemical and organic chemical products and kits to clients who use them for scientific and genomic research, biotechnology, pharmaceutical development, the diagnosis of disease, and as key components in pharmaceutical and other technology manufacturing. Launched in 1975 through the merger of Sigma Chemical Company and Aldrich Chemical Company, Sigma-Aldrich has grown at an above-average market rate in the course of its 30-year history. In 1975, the company had chemical sales of \$33 million, about 800 chemical employees, and operations in five countries. Today, Sigma-Aldrich has sales of \$1.8 billion, employs 7,300 people and operates in 35 countries worldwide.

Dana Plonka has been the director of internal audit (IA) for Sigma-Aldrich for seven years. She was hired to reinvigorate and refocus the IA function on strategic risk initiatives. At the time, with more than eight years of experience in internal auditing, along with a public accounting background, she was well-positioned to help breathe new life into the company's IA function.

According to Plonka, Sigma-Aldrich has the energy and vibrant outlook of a startup company. Every three years, company leadership creates an in-depth strategic plan. The most recent plan was created at the end of 2005, at which point the company was restructured into four business units, each with its own strategic and operational focus.

Plonka oversees six audit professionals on her team – two managers, two senior auditors and two staff members. “Because our corporate structure is a complex matrix, we all rely on integrated corporate functions, such as human resources and information systems,” Plonka says. “So, although we try to understand initiatives in each unit, we don’t separate our audit team along business unit lines.”

### An empowered audit team

Plonka cites informal auditor rotation as one of the unique characteristics of her self-motivated and empowered IA team. “It has never been my philosophy to formalize that process because I believe that it can be limiting with regard to individual goals and timing,” she says. “We keep the rotation of our auditors informal, and I try to instill a sense of team development instead. If our auditors wish to seek other opportunities, I encourage them to do so and help them consider and pursue their long-term goals. Being open with my team helps me reduce turnover.”

When hiring new auditors, Plonka looks for hard skills, such as public accounting and industry audit experience. “Our team is small, and given the profile of the company, I need these skills, which is why I don’t hire auditors directly out of college,” she says. “I look for a base level of intelligence, but I don’t want ‘by-the-book’ auditors. I look for a variety of softer skills, such as curiosity, creativity, practicality, innovation. Communication skills are important to me, as is a collaborative attitude combined with good problem-solving skills and an open, easygoing nature.”

Plonka keeps the organization as flat as possible. As a former “road warrior,” she is accustomed to jobs that require travel 60 percent to 70 percent of the time. She wanted to do things differently for her team, not just in terms of empowering auditors to have more control over their travel, but

also control over ownership, the ability to have an impact, and career development. “We operate in 35 countries and more than half of our sales are overseas,” she says. “We have significant operations, and therefore, significant audit risk outside of the United States. I keep travel at 35 percent because that is a reasonable, workable threshold for most people. To make this happen, we challenged ourselves to find ways to get our work done with less travel. For example, we try to find ways to do as much work as possible in our St. Louis home base before we do formal fieldwork. Also, we have reduced all three-week trips to two weeks, maximum. Our common goal is to keep the travel manageable for everyone.”

## A different approach to auditing

The Sigma-Aldrich organization and its IA team have a shared focus: people. The IA team has a highly supportive audience throughout the company. According to Plonka, in addition to the more traditional goals of assessing the adequacy of internal controls and the accuracy of financial reports, the IA function is dedicated to adding value and improving processes.

*The Improvement Guide: A Practical Approach to Enhancing Organizational Performance*<sup>1</sup> is required reading for all managers and employees at Sigma-Aldrich. “Individuals are evaluated annually on this process improvement initiative,” says Plonka. “Our mission is to help the company build a strong internal control environment and manage risk, while staying independent and managing risk issues as they emerge. We have companywide support, which helps foster a collaborative spirit, and so are uniquely positioned to make sure our recommendations are both value-adding and reasonable.”

While the IA team is not structured to align with Sigma-Aldrich business units, it does keep abreast of strategic initiatives to ensure that it is aligned with the three-year strategic plan. In the plan that was created in 2005, the five initiatives are:

- Align structure with customers and markets
- Focus on Internet superiority
- Expand in faster-growing economies (India, Brazil and China)
- Leverage process improvement for excellent investment returns
- Fill growth targets through acquisitions

In 2006, Plonka and her team visited two of the company’s targeted growth regions – Brazil and China – and provided support for the company’s review of the sales discount process in the United States. In 2007, in addition to performing audits in India and China, she plans to explore how the IA function can help the company meet its goal of remaining a market leader in e-commerce sales and marketing. This year, the IA team will also review the European sales discount process and perform audits of three recently acquired companies.

## Performance measurement

Last year, Plonka and the team implemented an Audit Satisfaction Survey, which was sent to all auditees following an engagement. Because of the generally collaborative atmosphere between the auditors and the company’s managers and employees, Plonka says she and her team were not surprised by the positive results of the survey. Performance is also measured by the degree to which the annual audit plan is achieved. “We manage audit report cycle time and have made significant improvements in our cycle time this year,” she says.

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<sup>1</sup>Langley, G.J.; Nolan, K.M.; Norman, C.L.; Provost, L.P.; and Nolan, T.W.; *The Improvement Guide: A Practical Approach to Enhancing Organizational Performance*; 1996; Jossey-Bass; San Francisco; California.

From the perspective of the company, the IA team is evaluated based on department goals, which cascade down from top management. “The company’s three-year strategic plan is used to formulate our organizational goals, and the IA team has to help meet those goals,” she says. “It is our job to add value to the company because, ultimately, in addition to our role facilitating a strong internal control environment, that is what is most important to management. In the past few years, with regard to Sarbanes-Oxley and the reassessment of those efforts, we have redirected our resources from compliance into value-add activities. We have been able to do this as we are a very well-controlled company.”

## Sarbanes-Oxley

Corporate governance regulations have had a tremendous impact on Plonka and her IA team. In 2003, the first year of Sarbanes-Oxley legislation, Plonka was appointed Sarbanes-Oxley compliance project leader under the company’s controller. “We partnered with Protiviti to define our scope and control matrices and implement templates and documentation,” she says. “We understood that IA should not own this process, but as the company’s control experts, we decided to use our skills and expertise to help management build the foundation for documentation. In 2003, my team was instrumental in developing control templates and quality assurance for the documentation.”

Also that year, Plonka and her team performed testing on behalf of management. Initially focused on the company’s top seven locations – the St. Louis headquarters, Milwaukee, Japan, the United Kingdom, Germany, France and Switzerland – the auditors tested approximately 10 to 12 processes in each location. “That year, we spent 70 percent of our resources focusing on Sarbanes-Oxley, and that significantly impacted our other IA plans.”

The following year, 2004, the internal auditors undertook a “mini-reassessment” of the work already performed. “We are a well-controlled company and that helps; fiscal responsibility is one of our key operating principles,” says Plonka. After reviewing the locations that were being visited and the processes under examination, the IA team redefined its scope, eliminating one location, as well as one process for all locations, and also reducing the work inherent in some of the tests. However, while that was happening, other areas were evolving. “We reduced work in some areas, but had to add work related to information technology,” Plonka says. “We also experienced some large acquisitions at that time, so the result was that we were still spending about 70 percent of our time on Sarbanes-Oxley.”

In 2005, while Plonka was preparing her annual audit plan, she realized that her team was exhausted and bored due to the lack of challenge inherent in focusing on compliance work. Wishing to significantly reduce the time her team was spending on compliance work, she worked with management and the audit committee to establish a plan to reduce the IA effort from 70 percent to 50 percent of its time. “We looked at expanding the team and at outsourcing Sarbanes-Oxley,” she says. “We also thought about moving the testing to our locations and asking the IA team to review the tests instead of conducting them.”

In the end, Protiviti helped Plonka and her team review and reengineer its Sarbanes-Oxley compliance process. Plonka, along with Sigma-Aldrich’s controller, CEO and CFO, were all in agreement with the reengineering option because it was the most sustainable way to reduce the compliance effort for all teams in all locations. The audit committee approved the changes. Early in 2006, Sigma-Aldrich embarked on a complete reengineering process for its Sarbanes-Oxley approach, which includes:

- **Scope** – As with most companies, the initial approach was conservative, with documentation of many controls and processes. This shifted to a more risk-based scope. “We took a fresh look at our approach, from a location and coverage standpoint. Before, we looked at every process at our top seven locations, and now we carve things up, creating an individual scope by location that does not include every process. We eliminated 20 processes out of the testing scope,” Plonka says.

- **Controls** – The team made a fundamental shift in relying more on preexisting corporate-level monitoring of certain controls, such as compilation of the monthly operations packet, which is reviewed by the controller and delivered to business unit management. “We leveraged existing controls and placed reliance on them. This is a huge shift for us. We’d been performing these controls forever, but in our initial Sarbanes-Oxley scoping, had focused most heavily at the location level. We augmented evidentiary documentation of controls in some areas and ultimately, were able to take detailed testing out of individual locations,” she says.
- **Testing** – The testing processes were reengineered in three areas:
  - Reliance on monitoring controls
  - Cross-reliance between processes, eliminating the “silo” approach
  - Testing controls without substantive tests. “When you’re testing reconciliation controls, if you have a completed and reviewed reconciliation in front of you, that is the test,” Plonka says.

The result: The reengineering efforts reduced the amount of time spent on Sarbanes-Oxley compliance to 40 percent, beating the audit committee’s goal of a 30-percent reduction. Today, Plonka and her team of six auditors spend only 30 percent of their time on Sarbanes-Oxley. “I finally feel that we are in balance,” she says.

Going forward, Plonka plans to solidify this new approach to governance, helping the company stay well-controlled and ensuring that resources are properly managed. “We will also take better advantage of our automated systems,” she says. “We continually challenge ourselves to look for ways to be more efficient and, along with others at the company, continuously reinvigorate our efforts to add value and refocus our strategies.”



## BUILDING A BEST-IN-CLASS AUDIT SHOP AT WASHINGTON MUTUAL

Washington Mutual, the sixth largest banking company in the United States based on total assets, conducts business through its four primary lines: retail banking and financial services, home loans, commercial banking and card services. The past 10 years have been marked by significant growth for Washington Mutual. In 1995, the organization employed more than 4,000 professionals and reported \$21.6 billion in assets. Today, Washington Mutual has increased those numbers to nearly 50,000 employees and \$346 billion in assets, an evolution that included 19 acquisitions and totaling more than \$200 billion in assets.

Washington Mutual's internal audit (IA) department mirrors the company's organizational structure, with an audit director assigned to each of the four lines of business. There are also four additional audit directors assigned to information technology (IT), credit risk, capital markets/finance/treasury, and a professional practices group that is tasked with driving efficiency, quality and innovation within each department's internal infrastructure. To keep pace with Washington Mutual's tremendous growth, the IA department is rebuilding and expanding its scope by establishing and pursuing the vision to become a best-in-class audit shop. The team is currently in year two of its five-year plan to rebuild and mature.

### Management objectives

Led by general auditor Randy Melby, who reports directly to Washington Mutual's audit committee and administratively to the chief enterprise risk officer, the IA department comprises 125 individuals. The management objectives and success factors that Melby and his leadership team have established for building a best-in-class audit shop are:

- Focusing on people as a competitive advantage
- Establishing effective partnerships with key stakeholders
- Implementing a core business plan
- Defining and delivering value-added services
- Establishing effective communications and reporting

To focus on people, Melby targets two key components designed to help instill a talent mindset and high-performance culture. Those components are an intense focus on career development and a commitment to deliver robust performance feedback. "Career development starts by working with each of our auditors to create career development plans," Melby says. "My premise and passion around this is that I set the formal training aside for a moment – and we do provide our auditors 80 annual hours of classroom training, which is important – because in my opinion, a lack of soft skills, leadership skills, are what cause people to derail in their careers. We try to unlock each person's passion, the things that make each person excited to come to work every day. Career development is a journey and you have to start early in a person's career to generate real benefits. This is an involved and difficult process that most managers simply do not do very well; however, if we can master it, I believe it is the key to recruiting and retention. Our goal is to make Washington Mutual the destination of choice for ambitious and talented audit professionals within the company and externally."

Just as important, according to Melby, is robust performance feedback – real-time, ongoing feedback that takes place throughout the year, rather than solely at annual reviews. "We stay in tune with each

person's career development plan, training progress and professional growth. The manager conducts midyear and annual performance reviews and captures each team member's performance. The goal of ongoing feedback is that it should lead to a no-surprise environment at the end-of-year review process," he says.

Throughout 2006, the department also focused on building strength by developing or bringing to the department a deeper understanding of Washington Mutual's business and its internal auditing focus. To assess the staff's skill level and potential, Melby and his team analyzed skill sets to identify any gaps in depth and breadth of knowledge. The training and recruiting programs were adjusted to address these gaps.

To partner with key stakeholders, such as senior management, the audit committee, external auditors, regulators, shareholders and customers, Melby says, "We need to understand the changing risk profile of our business as well if not better than management to become true business partners. By proactively partnering with clients, we can help provide solutions for improving the control environment and the quality of our services. Part of this requires determining how to interact with and audit the enterprise risk management function, assess strategic risk, maintain a global perspective of risk, and ensure IA's objectivity and independence. Right now, we are in our strategy-setting mode. Given the degree of change Washington Mutual is going through, the IA team has to be as hard-hitting and catalytic as possible, focusing on the high-risk areas that will move our company forward."

Implementing a core business plan includes mastering core competencies, applying best-in-class methodologies – such as integrated audits, which encompass business, IT, fraud and financial reporting – and using effective and accurate metrics to measure progress. The core business plan also depends on the professional practices group, which plays a critical role in establishing and monitoring internal infrastructure and helping to institutionalize discipline and the consistent application of the audit methodology.

Delivering value-added services starts with defining those services from the perspective of the IA team's primary client, the audit committee. To accomplish this, Melby has introduced the importance of differentiators, rather than qualifiers, to his leadership team. Qualifiers are the standard audit processes that the IA team must accomplish every day, such as assurance work, audit reports, work paper documentation and training. Differentiators are what drive the IA team to excellence and underscore the team's ability to deliver distinctive value to the company.

In addition, Melby recognized that the IA team can deliver value to the company by addressing strategic risk in addition to a traditional focus on risk. The completion of strategic risk audits, such as corporate governance audits, help improve the IA department's credibility with executive management. "Audits that focus on business strategy have provided insight to areas that are top-of-mind with company leaders," Melby says.

Finally, effective communication is a success factor because it helps Washington Mutual's board of directors and audit committee to carry out their responsibilities. The IA team provides meaningful reporting on audit plans and processes, comprehensive information on key risks, and strategies for collaborating with the enterprise risk management team to link control and risk assessments, so that the board and the audit committee receive complete perspectives and gain a full understanding of what is reported to them. As the IA team is now in the second year of its five-year plan, its focus has broadened to include benchmarking of the IA industry in order to plug into networking groups and obtain "apples to apples" comparison on metrics.

Working toward these management objectives has changed the role of IA within Washington Mutual. "As we get better at what we do and we move closer to our best-in-class vision, we tend to create a level of constructive tension between audit and management," Melby says. "This results from bringing strategic risk issues to the forefront that significantly impact the organization's risk profile. This is what we get paid to do."

“Any constructive tension created is dealt with professionally by both audit and management and is healthy from a corporate perspective. We view ourselves as corporate stewards and work with management to resolve issues by providing actionable recommendations and leveraging our risk management expertise,” he says.

## Skills matrix

To continue to grow and groom the IA team, Melby and his leadership team look for a wide range of specific hard and soft skills that fall into three general categories:

- **Core audit skills** – Those that apply to the activity of internal auditing in general, whether at a bank or any other organization.
- **Professional and leadership skills** – These include soft skills such as coaching, feedback, verbal skills, collaboration, negotiation techniques and mentoring skills.
- **Business skills** – These are skills that are needed to understand the businesses being audited, such as retail banking, loan underwriting and servicing, credit card operations and off-balance sheet products.

“If individuals have areas they want to work on or improve, we find that they fall in one of those three areas,” Melby says. “We have a master academic plan to teach as many of our core skills as possible. We are trying to develop people in our training programs, not just to be better auditors, but to be better professionals in general. Sometimes, IA departments neglect professional and business skills, [but] we try to provide a robust development plan for all our people.”

## Vision for the future

The vision that Melby and his leadership team share rests on three basic concepts:

- **An intense focus on people** – “That is my drumbeat,” he says. “We are looking to create a high-touch experience and to do that, we must embrace the mindset that the audit leadership team comes to work every day to serve their teams, not the other way around.”
- **An ability to deliver better and improved services at a lower cost** – “We can achieve this by improving our productivity, defining our efficiency ratio, and establishing key metrics that will help the audit committee and executive management determine how we are improving our efficiencies,” he says. To contain costs and increase efficiency, the IA team plans to invest in automated monitoring to cut back on audit work while still effectively measuring risk efforts throughout Washington Mutual.
- **A greater focus on strategic risk** – “We have to look beyond the everyday audit details and toward managing risks and achieving growth and strategic goals,” Melby says. “Now is the time for our team to be a catalyst for change.”

## PARTNERING FOR SUCCESS: INTERNAL AUDIT AT WELLS FARGO

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Wells Fargo & Company is a diversified financial services company providing banking, insurance, investments, mortgage and consumer finance to customers through 6,000 stores, the Internet and other distribution channels across North America and internationally. Headquartered in San Francisco, Wells Fargo has \$482 billion in assets and 158,000 team members across more than 80 businesses. The bank is one of the top 40 largest private employers in the United States.

Kevin McCabe has been executive vice president and chief auditor at Wells Fargo since January 2003. McCabe worked for a Big Eight accounting firm for six years and obtained his CPA, then moved to Bankers Trust Company where he became proficient in money center banking, especially auditing trading floors. He spent 15 years in Asia and Europe, and credits that time overseas with when he learned how to operate a team away from headquarters – an important ability for the leader of an audit team. “When you are 12 time zones away, you have to make decisions and defend them on your own,” he says.

Wells Fargo’s main business lines are regional banking, which includes stores, ATMs and cards; home mortgages; a finance company; and wholesale banking. While the bank has offices in Canada and the Caribbean, and small offices in Asia and Europe, approximately 98 percent of Wells Fargo’s business is in the United States.

The Wells Fargo Audit and Security (WFAS) group comprises an audit services team of 300 full-time employees and a corporate security team of 300 professionals. The reporting line in audit services is a formal, documented, four-page process that has been approved by the audit committee: McCabe’s functional line is to the audit committee – including approval of the audit plan and budget, as well as his performance appraisal and compensation – while his administrative line is to the CEO and chairman. “Both are important,” he says. “Without the CEO line, it would be easy to be excluded from key meetings or distribution lists, and without the audit committee it would be harder to be independent.”

### The Rotational & Training program

To build and maintain an effective internal audit function, WFAS embarks on an active college recruiting effort, hiring graduates from top schools. These candidates will enter the team’s Rotational & Training (R&T) program, an initiative that, over the past four years, WFAS has expanded, from five hires a year to an intended 20 in 2007. “We want our R&T program to be first-rate and we want to reach a point where all our new hires can take and pass the CIA within one year of hire,” says McCabe. “We will be designing our Year Two objectives this year, and have hired a full-time learning and development manager to head the R&T program to help ensure its success.”

At the more senior levels, Wells Fargo hires candidates either through an employee referral program that rewards existing staff for referrals, or through a Web post that announces jobs both internally and externally. “As a result, we have hired more than 50 team members the last two years at a recruitment cost of less than \$3,000 per employee,” McCabe says. “We have promoted almost all of the team’s managers and above from within the group the last four years.”

## Vision and values

During the past two years, McCabe has devoted a significant amount of time and energy to his team's vision and values, which are modeled after Wells Fargo's. "After making many significant improvements to our policies and processes, we are able to rate ourselves 'good' against The IIA, SAS 65, and OCC standards," McCabe says. "We now need to find a way toward 'great' and we have decided the way to jump up performance is to have everyone on the same page as to what really are the most important objectives. Then, we need to make sure that all our initiatives and our communications tie into these objectives."

To accomplish this, the five strategic objectives WFAS has identified are:

1. Risk management as great as our company
2. Business partners value and trust us
3. One Wells Fargo audit team
4. A great place to build a career
5. Prudent management of resources

Each strategic objective is assigned a series of performance measurements, as well as a person or team accountable for monitoring and managing its progress. "All of our department communications, projects and compensation are tied into our five strategic objectives," McCabe says.

He adds, "These objectives define where we want to be and what we need to do over the next several years to make us a great audit department."

## RCSA

Several key audit services initiatives are underway at Wells Fargo and many of them are tied to companywide change. For example, the bank is implementing an Enterprisewide Risk and Control Self-Assessment (RCSA) tool, which every group will populate with risk and control data using the same risk-loss standard language. "This powerful tool will allow Wells Fargo to aggregate the top risks and control weaknesses," McCabe says. "Once completed and audited, the RCSA will replace our own risk assessment process that we use for planning our audit cycles. It will be easier and better than anything audit could have done. It will also drive our business monitoring program by allowing us to analyze changes each quarter. We will evolve from 300 auditors looking for change to 2,000 to 3,000 business team members updating changes."

The RCSA will help auditors to examine operational risk, which WFAS defines as financial, operational, technology and compliance risks. RCSA captures the inherent risk using an enterprisewide risk scale and the control rating to derive a residual risk. The information can be rolled up and aggregated for review at each level in the bank, including the board of directors. WFAS will be able to focus its work on the highest residual risks and monitor negative changes quarterly, determining if additional coverage is warranted.

"This enterprisewide initiative is pushing management to conduct more self-assessment," McCabe says. "It is also moving us to a five-tier rating, rather than our current three-tier rating, which gives us more subtlety in our risk descriptions."

## Performance measurement

Annual performance measurement for WFAS takes into account three key metrics:

- 95 percent of the adjusted audit plan must be completed by December 31
- Less than 10 percent of audits are started out of cycle versus audit cycling guidelines (i.e., the audit cycle for high-risk audits is every 12 months; for low-risk audits it is every 36 months)
- Internal quality assurance scores must average 80 percent or higher

“In addition, we target maintaining or improving our satisfactory rating from regulators and we measure the time we spend on our audit work; for example, our fieldwork should take less than 75 days, and reports should be issued in less than 30 days,” McCabe says. “These metrics are reported to the audit committee, but they are not on the same level of importance as the three key metrics in the first group.”

To gather further feedback on performance and expectations, WFAS annually surveys the audit committee members, management committee members, and a sample of line managers, using the Corporate Executive Board – Calibrating Stakeholder Expectations (CASE) survey tool, the results of which are typically positive, but do identify areas that need work.

This type of direct feedback from and involvement with management is important to McCabe. “WFAS is included on every important committee in Wells Fargo,” he says. “We attend non-executive sessions of the board of directors, as well as the audit, finance and credit committees. We are on the management committee, the Sarbanes-Oxley disclosure committee, the Basel II steering committee and the various compliance committees. Communication at these meetings is honest and frequent.”

## Corporate governance

Wells Fargo has reviewed, modified or confirmed almost every facet of corporate governance in the bank for the past four years, including the audit committee charter and the reports received by that committee. “In addition, Wells Fargo has helped create a new enterprise risk management (ERM) committee and has significantly increased and improved the corporate compliance policy wording and monitoring techniques. The list is very long,” McCabe says.

Yet, historically, the role WFAS has played in Sarbanes-Oxley work has been light. The bank’s controller runs the process by establishing the scope and setting control documents, standards for testing, and quality assurance results, then drives the process through the business-line controllers. WFAS tests the quality of documentation and results during the normal audit cycle as it audits the business. “Our testing is not geared toward completing any specific sample each year or completing our work in Q4 so that our external auditors can rely upon our findings,” McCabe says. “This might change if the SEC and PCAOB change the rules about the ability of the external auditors to rely upon the work of others.”

According to McCabe, the biggest change his team has faced is in assuming the responsibility to provide all independent testing for compliance efforts in general, and specifically, with regard to the Anti-Money Laundering/Bank Secrecy Act (AML/BSA). “We used to devote five percent of our resources to compliance testing,” he says. “We increased our head count in this area and it now takes up to 15 percent of our FTE.”

## Vision for the future

McCabe's vision for audit services is to become a team that fully leverages all risk management functions to support a strong monitoring process of key risks that emerge between audits, as well as implement effective planning of audit scopes. "Each business line employs some sort of risk management group to perform a variety of functions," he says. "We have an unprecedented opportunity to work with these groups to improve their scope and processes. We want to increase our team's use of these groups as they become more consistent."

McCabe points to four pivotal events that have helped WFAS form this vision:

- Dramatic increase in business line self-testing and reporting (driven in part by the Sarbanes-Oxley Act, especially Section 404)
- Increased regulatory focus (including Basel II), and attention on enterprisewide risk management practices and tools (namely RCSA)
- Improved corporate governance processes for all major business lines and at the board level, and the consolidation of risk managers within the four large business groups: Community Banking, Home Mortgage and Consumer Finance, Wholesale Banking, and the Technology Information Group
- Increased pressure for more consistency in scope, process and reporting from each risk management group

"In banking, I think the big changes will stem from moving out of the top of the credit cycle," he says. "Regulators have been focused on rules such as the AML/BSA and reputation risk management. With the changing interest rate environment, we will get back to the basic worries about financial strength. We have been increasing our coordination with credit audit for some time, and we will continue to increase our testing of underwriting, exceptions and collections to stay ahead of problems. I have no doubt there will be many new rules coming out as a result of the bad underwriting practices by some companies at the top of the credit cycle."

## ABOUT PROTIVITI INC.

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Protiviti ([www.protiviti.com](http://www.protiviti.com)) is a leading provider of independent risk consulting and internal audit services. We provide consulting and advisory services to help clients identify, assess, measure and manage financial, operational and technology-related risks encountered in their industries, and assist in the implementation of the processes and controls to enable their continued monitoring. We also offer a full spectrum of internal audit services to assist management and directors with their internal audit functions, including full outsourcing, co-sourcing, technology and tool implementation, and quality assessment and readiness reviews.

Protiviti, which has more than 50 locations in the Americas, Asia-Pacific and Europe, is a wholly owned subsidiary of Robert Half International (NYSE symbol: RHI). Founded in 1948, Robert Half International is a member of the S&P 500 index.

### Internal audit services

Protiviti provides a full spectrum of services, technologies and skills to management, directors and the internal audit community. We provide world-class professionals and state-of-the-art methodologies and tools. Our network allows us to offer the right resources at the right time and in the right place to meet your needs.

Among the services Protiviti's internal audit practice provides are:

- Audit committee advisory
- Co-sourcing and specialized resource enhancement
- Full outsourcing
- Internal audit technology and tool implementation
- Internal audit quality assessments and readiness reviews
- Internal audit transformation
- Information technology audit services
- Startup and development advice

### Other relevant publications and resources from Protiviti

- *Moving Internal Audit Back into Balance: A Post-Sarbanes-Oxley Survey* (Second Edition)
- *Guide to Internal Audit: Frequently Asked Questions About the NYSE Requirements and Developing an Effective Internal Audit Function*
- *Top Priorities for Internal Audit in a Changing Environment*
- *Guide to Enterprise Risk Management: Frequently Asked Questions*
- *Guide to the Sarbanes-Oxley Act: Internal Control Reporting Requirements* (Third Edition)
- *Internal Audit Capabilities and Needs Survey*
- Supply-chain white paper series from Protiviti and APICS
- KnowledgeLeader<sup>SM</sup> ([www.knowledgeleader.com](http://www.knowledgeleader.com))

### Information technology internal audit co-sourcing and information technology-related Sarbanes-Oxley compliance solutions

Protiviti provides a broad range of IT internal audit co-sourcing and outsourcing solutions. Our IT internal auditors have broad expertise to assist in all aspects of IT audit services, from the defining of the audit universe and performing the risk assessment, the annual planning and scoping process to

the execution of all types of technology-related internal audits. We also provide consulting services around technology risk and control aspects of Sarbanes-Oxley compliance. We provide expertise in documenting critical business processes, identifying risks and mitigating controls, analyzing performance gaps, and recommending and implementing action plans to improve controls.

We help companies understand and evaluate technology risks related to:

- Technology audit planning and risk assessments
- Application control review and internal audits
- Security assessments and internal audits
- Business continuity
- Technology process controls reviews and internal audits
  - Change control and management
  - Security administration
  - Data center operations and problem management
  - Asset management

## KnowledgeLeader<sup>SM</sup> provided by protiviti®

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KnowledgeLeader<sup>SM</sup> is a subscription-based website that provides information, tools, templates and resources to help internal auditors, risk managers and compliance professionals save time, stay up-to-date and manage business risk more effectively. The content is focused on business risk, technology risk and internal audit, and is updated weekly.

The tools and resources available on KnowledgeLeader<sup>SM</sup> include:

- **Audit Programs** – A wide variety of sample internal audit and IT functional audit work programs are available on KnowledgeLeader<sup>SM</sup>. These work programs, along with the other tools listed below, are all provided in downloadable versions so they can be repurposed for use in your organization.
- **Checklists, Guides and Other Tools** – More than 400 checklists, guides and other tools are available on KnowledgeLeader<sup>SM</sup>. They include questionnaires, best practices, templates, charters and more for managing risk, conducting internal audits and leading an internal audit department.
- **Policies and Procedures** – KnowledgeLeader<sup>SM</sup> provides more than 200 sample policies to help in reviewing, updating or creating company policies and procedures.
- **Articles and Other Publications** – Informative articles, survey reports, newsletters and booklets produced by Protiviti and other parties (including *Compliance Week* and Auerbach) about business and technology risks, internal audit and finance.
- **Performer Profiles** – Interviews with internal audit executives who share their tips, techniques and best practices for managing risk and running the internal audit function.

Key topics covered by KnowledgeLeader<sup>SM</sup>:

- Business Continuity Management
- Control Self-Assessment
- COSO
- Credit and Operational Risk
- Enterprise Risk Management

- Fraud and Ethics
- Internal Audit
- Sarbanes-Oxley and Corporate Governance
- Security Risk
- Technology Risk

Also available on KnowledgeLeader<sup>SM</sup> – Methodologies and models, AuditNet Premium Content, discounted certification exam preparation material, discounted CPE courses, white papers, audit, accounting and technology standards, and best business links.

To learn more about KnowledgeLeader<sup>SM</sup>, sign up for a complimentary 30-day trial by visiting [www.knowledgeleader.com](http://www.knowledgeleader.com). Protiviti clients and alumni, and members of The IIA, ISACA, the AICPA and AHIA, are eligible for a subscription discount. Additional discounts are provided to groups of five or more.

### Introducing KLPlus<sup>SM</sup> (KL+)

On June 25, 2007, KnowledgeLeader<sup>SM</sup> members will have the option of upgrading to KL+. KL+ will provide all of the benefits of KnowledgeLeader<sup>SM</sup>, and for 50 percent or more off of the standard price, full access to Risk Solutions iTraining (see the following iTraining section).

## PROTIVITI'S RISK SOLUTIONS iTRAINING DEVELOPMENT SERIES

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Protiviti's Risk Solutions iTraining is a comprehensive collection of interactive, Internet-based training courses offering a rich source of knowledge on internal audit and business and technology risk management topics that are current and relevant to your business needs.

Topics include:

- Introduction to Self-Assessment
- Testing and Controls
- Information Technology (IT) Audit
- Enterprise Risk Management
- Audit Project Management
- Sarbanes-Oxley Act Compliance

Composed of materials originally developed for training Protiviti's consulting professionals, these courses are designed to give organizations and individuals a high-quality learning experience in a convenient format. The wide array of courses provides process owners, general management, boards of directors and other professionals with continuing education opportunities they can access anytime via the Internet. Protiviti's iTraining offerings also qualify for CPE credit.

This content can give you and your employees a significant advantage as you face continuing regulatory, corporate governance and internal control challenges. Courses incorporate real-life knowledge and practical skills that can be immediately applied within the work environment.

For more information, visit [www.protiviti.com](http://www.protiviti.com).



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Protiviti is a leading provider of independent risk consulting and internal audit services. We provide consulting and advisory services to help clients identify, assess, measure and manage financial, operational and technology-related risks encountered in their industries, and assist in the implementation of the processes and controls to enable their continued monitoring. We also offer a full spectrum of internal audit services to assist management and directors with their internal audit functions, including full outsourcing, co-sourcing, technology and tool implementation, and quality assessment and readiness reviews.

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