



INTERNAL AUDITING  
AROUND THE WORLD

*Profiles of Internal Audit Functions  
at Leading International Companies*

VOLUME II

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Independent Risk Consulting

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## INTRODUCTION

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### *Global risks, global solutions*

Around the world, organizations face escalating financial, operational, strategic and physical risks that have been increasing steadily in terms of impact, likelihood and complexity. This should come as no surprise as the pace and complexity of change continue to accelerate regardless of geography. Corporate governance regulations and guidelines, financial reporting requirements, operational efficiencies, customer satisfaction levels – all these factors drive the internal audit functions of multinational companies to add value beyond any standard that has been set in the past.

That these risks resonate through companies worldwide has led to a phenomenon in the internal audit profession – a formal and informal sharing of internal audit best practices and lessons learned among companies in every region of the world. More and more, the companies we profile describe the ways in which they draw from the experiences of their peers to identify risks, share solutions and learn from each other's methodologies and approaches. The internal audit community is both expanding and getting smaller as our profession raises the bar on its own performance, assuming the roles of trusted business advisors and strategic consultants within our organizations.

The companies featured in this book represent different regions, industries and markets. They are highly successful organizations competing in a dynamic global landscape. Excellence is the benchmark for these organizations – their internal audit functions have been shaped and, in some cases, reinvented by this level of achievement.

The primary objective of any internal audit function is to provide assurance to the audit committee and management regarding the efficacy of controls, management of risk and effectiveness of corporate governance. However, the companies featured in this book go beyond those objectives. They deliver value by facilitating operational improvement and promoting best practices across the enterprise. They create synergies with external auditors to avoid duplication of audit work and enhance controls. They build relationships with senior management to strengthen the commitment of the company to risk management improvements. They seek disciplined and talented internal audit professionals who embody integrity.

Often, internal audit leaders are tasked with unique challenges. At Time Warner Inc., Steve Fiedler and his management team helped develop a global audit brand. Historically, the reports produced for the individual divisions at Time Warner used dissimilar language, format and style of reporting. Fiedler built a global brand to ensure that all audit reports had a standard language, look and feel, making it easier to integrate audit findings and efforts across the organization.

At T-Mobile USA, Inc., Mike Rimkus and his team led a comprehensive initiative called the Business Risk Measurement Framework, designed to help auditors and the company's leadership stay abreast of the rapid growth that has come to characterize the company.



Hubertus M. Buderath at DaimlerChrysler developed a Risk Oriented Planning Procedure that contains a “Red Flags” process, which was developed through experience and by benchmarking with other companies. These Red Flags help the internal audit team identify critical areas, processes, projects and transactions throughout the company.

As is the case with many of the companies we profile in this publication, Amcor Limited is designing a comprehensive response to Sarbanes-Oxley requirements, initiating a worldwide project to document and evaluate internal control over financial reporting. According to Peter Black, this project enabled Amcor to target processes that required improvement, helping the internal audit team enhance internal controls and motivate change at an accelerated rate.

Reading these profiles of leading internal audit functions is just one way to participate in the global internal audit industry phenomenon of change and improvement, of discussing risk and sharing solutions, of continuing to elevate our own performance and searching for new ways to create efficiencies and contribute to the excellence of our organizations.

Strong interest in our 2005 *Internal Auditing Around the World*, the first in the series, has encouraged Protiviti to produce a new volume on an annual basis in which we will profile different leading companies’ internal audit functions. Our goal is to provide helpful information to internal audit professionals worldwide and offer fresh insight into their changing roles. We’re confident this series will continue to be received favorably by those in the profession, as well as CEOs, CFOs and boards of directors.

Protiviti Inc.  
June 2006

### *Acknowledgements*

Protiviti would like to acknowledge The Institute of Internal Auditors (The IIA) for outstanding worldwide leadership in developing and promoting the internal auditing profession. The IIA continues to provide opportunities for professionals to enhance their expertise in the field and adapt to the evolving needs of their organizations. We also wish to thank Nancy Hala for her valuable work in conducting the interviews and writing the informative company profiles contained in this publication.



## GROUP INTERNAL AUDIT AT AMCOR LIMITED

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Amcor Limited is one of the world's largest packaging companies with annual sales of approximately AUD\$11.0 billion, and 224 plants located in 36 countries. With approximately 27,000 employees and 126,000 shareholders, the company has substantial packaging businesses in five geographic areas - Australasia, North America, Latin America, Europe and Asia.

Headquartered in Melbourne, Australia, Amcor derives about 80 percent of its earnings from outside Australasia. Within Australasia, Amcor offers a wide range of packaging and packaging-related services, including:

- corrugated boxes
- cartons
- aluminum and steel cans
- flexible plastic packaging
- PET plastic bottles and jars
- multiwall sacks

Internationally, the company is focused on four key market segments:

- PET plastic bottles and jars
- flexible plastic packaging
- corrugated and distribution
- tobacco packaging and specialty folding cartons

Peter Black has been with Amcor for 37 years in various financial and operational positions. For the past 10 years, Black has been Amcor's group general manager of the company's Group Internal Audit (GIA) function, overseeing 24 auditors, excluding GIA's two Sarbanes-Oxley Section 404 coordinators. The GIA staff is complemented through a co-sourcing arrangement with a professional services firm that takes responsibility for the company's internal audit activities in Mexico and provides supplementary co-sourcing in Europe, Australasia and other parts of North America.

The GIA team is regionally structured with staff located in Australia, Singapore, England, Belgium and North America. The team is primarily focused on the financial aspects of audit, rather than the operational components. "We do at times become involved in operational audits," says Black. "However, because our product groups are so diverse it is impossible for our team to possess all the skill sets needed to cover the entire company. We believe that the business management groups should be in charge of their own operational reviews, and, in fact, most of the business groups do conduct their own special operational reviews. Our prime focus is on internal controls and financial reporting for the organization."

## *Auditing skills*

The mission of Black's team is to provide independent assurance to the Amcor board of directors through the Audit & Compliance Committee. This assurance reflects the current state of Amcor's systems of internal control and provides management with recommendations designed to enhance those controls and improve operational performance. "Our goal is to add value to the business and reduce risk," says Black.

In attracting auditors who can help the GIA team achieve its mission, Black looks for a specific range of skills. "We regard GIA as a training and developing group for the recruitment of Amcor staff to financial and operational roles," he says. "We seek auditors who want to move into operational roles, remaining in audit for no more than three years. We have a high turnover of staff because of this model, but we do not try to keep extra staff in the group, which is one reason we have leveraged our co-sourcing arrangements. The only exception to this rule is our information technology (IT) staff and the one or two senior managers with more of a career auditing focus.

"The hard skills we look for are essentially IT specific for the IT auditors. Soft skills include effective communication and an ability to work as an active member of the team. We focus on reporting skills and a dedication to high-quality, consistent work. Also, I seek out individuals who are confident and capable of presenting to and interacting with diverse groups in new situations, whether they be Russia, China or here in Australia."

## *Goals and objectives*

According to Black, the Audit & Compliance Committee recently requested an external review of the GIA function, which resulted in a report with recommendations for improvement. Many of those recommendations have been incorporated into GIA's three-year strategic plan that was issued in May 2005. The plan identifies five key areas of focus for the GIA team – organization, people, working practices, communication and measurement – and strategic goals and objectives for each area:

- Organization – Establish a risk-based plan providing assurance to the Audit & Compliance Committee on key risks, using the outputs from the Business Risk Management Framework and GIA's own risk models to develop a risk-based internal audit plan. Additionally, broaden the operational and assurance scope of work performed by GIA beyond financial controls.
- People – To develop future Amcor leaders, build a regionally skilled and flexible resource model that reflects GIA's specialized needs, taking into account Amcor's globalization, risk profile, assurance requirements and a need for flexibility. Foster a reputation in which GIA is seen as a development ground for future Amcor leaders.
- Working practices – Continually upgrade work practices to meet best practice expectations, encouraging the Audit & Compliance Committee and other management groups to assume a greater role in developing the internal audit plan. Consistently apply best practice internal audit methodology across GIA.
- Communication – Improve reports presented to Audit & Compliance Committee and other management groups to provide users with an overview of GIA activities, findings, conclusions and management actions. The audit reports also should help line management better manage their businesses.
- Measurement – Measure performance to drive improvement within GIA by developing key performance indicators linked to a balanced scorecard that focuses on qualitative and quantitative aspects to drive value to stakeholders and GIA staff. Conduct an annual self-assessment of GIA and consider external independent reviews every three to five years to ensure continuous improvement.

The five goals are aligned with the organization's Business Risk Management Framework. "In March 2005, for the first time Amcor conducted detailed risk workshops by business group, producing a number of inherent and residual business risks, some of which were auditable," says Black.

When integrating the outcomes of the Business Risk Management Framework into Amcor's internal audit approach, GIA adopts the following action steps:

- Champions the establishment and maintenance of the Framework
- Evaluates and gives assurance on the risk management processes
- Provides assurance that risks are correctly identified and evaluated
- Assesses the reporting of key risks
- Reviews the management controls covering identified key risks

"The roles GIA does not undertake include setting the risk appetite, designing and accounting for risk management processes, responses and mitigation of risks, and making decisions on risk responses," says Black. According to the strategic plan, GIA will operate in relation to its risk management role in compliance with current best practice thinking, bearing in mind that this is an area that is still evolving.

GIA ensures its own independence with regard to the implementation of Business Risk Management Framework outcomes and will not reduce the requirement for managers to monitor risks within their area of responsibilities or the mitigation strategies designed to deal with them. GIA will challenge the basis of management risk assessments derived from the Business Risk Management Framework and evaluate the adequacy and effectiveness of risk treatment strategies.

"In addition to the Framework, we are beginning to look at our resource model to determine if our department possesses all the skills necessary to complete our work for the Audit & Compliance Committee or if additional skills, such as project management, are needed," says Black.

"This is one of our five strategic goals: a focus on people. We also are refining our approach to audit follow up. We have designed a process in which the auditors feed all audit report issues and action plans into a Web-based system that is segmented per business group. The system indicates who is responsible for each action step and allows both management and audit staff to monitor progress. We performed a trial test of this system in two of our business groups, and we are now ready to expand the system throughout the globe. Our goal is to ensure that action plans are completed in a timely manner. These action plans address the control issues identified in the audit, which are ranked 'major, moderate and minor' in terms of importance and likelihood of impact."

### *Sarbanes-Oxley – Section 404*

In response to Sarbanes-Oxley Section 404 requirements, Amcor initiated a worldwide project to document and evaluate internal controls over financial reporting. This project enabled the company to target processes that required improvement. As these opportunities were identified by members of the project team, discussions were held with management and action plans were agreed on, instigated and monitored.

"The worldwide project we established to comply with Sarbanes-Oxley was fairly significant as we had to cover such a variety of regions, many with disparate regulations and guidelines. The great benefit of Sarbanes-Oxley, for us, is that it has helped us improve our internal controls, motivating change at a much faster pace than we might normally have taken," says Black.

GIA's vision is to become a world-class internal audit function, one that is sought after by Amcor management to assist the business in improving efficiency and internal control standards. "We want to be perceived as a valued resource," Black says.



## INFLUENCING CHANGE AT AUSTRALIA AND NEW ZEALAND BANKING GROUP LIMITED

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Australia and New Zealand Banking Group Limited (ANZ) is headquartered in Melbourne, Australia, where it first opened an office as the Bank of Australasia in 1835. ANZ is one of the five largest companies in Australia and the largest bank in New Zealand following its purchase of The National Bank of New Zealand. With assets of AUD\$293 billion, the bank has more than six million personal, private banking, small business, corporate, institutional and asset finance customers worldwide.

ANZ consists of numerous operating divisions, including personal, institutional, corporate and business banking, and asset finance with concentrated strategic efforts in overseas divisions such as New Zealand and Asia-Pacific. The bank's corporate center houses functions such as operations, technology and shared services, as well as risk management, group strategic development and financial management.

Richard Moore brings a strong background in advisory services surrounding governance, risk management and internal audit to his current role of Group General Manager – Audit for ANZ, a position he has held for two years. “Coming to this role was a nice fit to what I had done previously,” he says.

There are approximately 100 people in the internal audit (IA) function. A deputy head auditor reports directly to Moore, along with 11 audit directors who lead the group's audit activities. Moore reports to the chairman of the audit committee. Currently, about 75 of ANZ's auditors are in Australia, 20 are in New Zealand and two are based in London.

### *Staffing strategies*

When Moore joined the group two years ago, the IA function consisted of 60 auditors and of those, approximately one-third left in the months following to pursue opportunities elsewhere in the bank. “Auditors typically stay for three to five years in the IA function,” Moore says. “I have recruited approximately 50 professionals in the past two years, both as part of our growth and to replenish the staff we lost through normal attrition. Recruitment is a major focus of our initiatives, and we set high standards for our new hires. Building the quality of the audit team and making sure the type of auditors we recruit are prepared to add value to other parts of the bank has been a primary goal of mine. Our staffing strategies include both internal recruitment from the bank – we've taken on a number of people who see a role in audit as a chance to broaden their banking experiences – and external recruitment of professionals with strong IA and banking skills.

“The hard skills we look for include core banking knowledge, industry experience or strong IA experience. In a minority of cases we hire individuals who have neither banking nor IA backgrounds. All of our staff go through external consulting skills courses, which we see as a necessity for all staff.”

### *Influencing change*

The objective of the IA team at ANZ is to provide an independent and efficient service to help the board of directors meet its statutory and other obligations. “We are here to provide the assurance that the board and senior management require with regard to the internal control and risk management

systems that apply across the bank,” Moore says. “We are focused on internal control. The bank has a strong and separate risk management function, so we are not responsible for the ERM initiatives, but we do assess the effectiveness of those efforts.”

The audit methodology has been reviewed and revised over the past 12 months. When Moore joined ANZ, there was a strong IA function in place that produced quality audit work. However, due to his initial major recruitment effort, Moore realized that the team lacked a robust audit methodology that could help teach recruits how to navigate the requirements of the audit function. “Not much was documented,” he says. “As a result, we developed a new and comprehensive methodology, which is much more defensible in the eyes of regulators and other stakeholders who might review, assess and challenge our audit approach.

“We have always had a risk-based approach to auditing and that has not changed, but we have not been able to look at the methodology from top to bottom. So we introduced new thinking in some areas, although it is not fundamentally different,” he says.

The new audit methodology is built on five key principles that are designed to influence change and protect and enhance the assets of ANZ:

- A risk-based approach from planning to execution
- A focus on business that helps align business objectives to the audit work and ensures there is an appropriate emphasis on high-risk issues
- A focus on staff development to involve all staff in the end-to-end process of the reviews performed, and to provide clear expectations for them, as well as coaching for all staff at all levels
- Emphasis on timeliness of reporting to ensure that audit issues are communicated to the right people on a timely basis
- Dedication to governance, ensuring that the audit methodology is applied first and foremost to produce robust and defensible outcomes

“By being business focused and prioritizing our efforts on the high-risk areas, we ensure that we remain relevant,” Moore says. “This, combined with our recruiting of high-caliber staff, helps the IA function achieve its goal of influencing change to protect and enhance shareholder value.”

### *Measuring performance*

Moore introduced the balanced scorecard approach to performance measurement when he joined ANZ. This approach consists of five critical components:

- Staff – The IA team monitors the length of time audit staff are retained, as well as the amount of training and development opportunities provided to each auditor.
- Customers – Following each audit, a survey is presented to the audit customer asking for feedback on the audit performance. Additionally, Moore and his team examine metrics around the timeliness of reporting. Three key reports are issued for each audit: A flash report is issued within two days of completing field work, a draft report is issued within 10 days, and a final report is issued within 20 days. These timetables contribute to overall performance measurement.
- Quality – There are two aspects to the quality measurement: First, the IA team monitors whether problems that emerge in the bank emerge in areas where the team has recently conducted an audit; if the problem was left unidentified, that is an indicator of poor performance. Second, if the problem arises in an area of the bank that was not scheduled for an upcoming audit, that indicates the team’s risk assessment and audit planning is not as effective as it should be. At the same time, the IA team keeps track of where it has significantly influenced change in the business.

- Management – The management of the audit plan ensures that the plan is completed effectively and efficiently. The three-year audit planning cycle is updated annually and is closely monitored. Also, management of the audit budget is closely monitored as actual costs are charged back to the business.
- Governance – The IA function recognizes and, where appropriate, adopts good governance practices, reporting its performance to the audit committee and periodically seeking external quality assurance feedback.

The relationship between auditors and business unit managers is collaborative. “I have a wide range of meetings with various individuals across the organization, predominately at the management and board level, and those meetings are designed to both give and receive information,” Moore says. “I expect my direct reports to have similar meetings with their peers to accomplish the same communication and knowledge sharing. Across the board, we have a significant amount of interaction to gain optimal understanding of the business operations so that we can add tangible value,” he says.

“I have been consulting on corporate governance for many years, and the attitude of the clients and corporations in Australia has been based on the principle of good governance, determining how best to apply governance practices in the most feasible and effective way within an organization,” Moore says. “Many of the newer expectations and requirements are not so new in Australia. From a Sarbanes-Oxley perspective, the requirements are being rigorously applied with U.S. registrants in a manner similar to how they are applied in the United States. We are trying to learn from the mistakes that were made in the U.S. It is a massive undertaking and occupies a significant amount of management and audit time and resources to make sure that we comply.

“IA has shifted its position on Sarbanes-Oxley at ANZ in the past few months,” he says. “Up until nine months ago, IA only had an oversight responsibility with regard to Sarbanes-Oxley. We are now conducting all the testing related to Sarbanes-Oxley, with the exception of general computer controls, on behalf of the business. It is a collaborative effort between the business and IA to achieve readiness. Additionally, IA continues to have an oversight role on progress and we independently report back to the audit committee and management.”

According to Moore, while Sarbanes-Oxley has not dramatically altered the IA role, it has created additional responsibility and accountability. “We treat it as a new area of audit and we report it as such to the audit committee, but it has not created new dynamics.”

### *Future challenges*

Challenges for the future include an ongoing effort to ensure that ANZ has an appropriate level of experienced, talented audit staff. “Given the increasing demand for qualified internal auditors worldwide, we have to continue to demonstrate we are a leading audit department if we want to attract the right caliber of audit professional,” Moore says.

Another challenge Moore points to is remaining relevant to the business, making sure he and his team direct their resources toward the higher risk areas within the bank, always adding value to the rapidly changing, global business.

“Finally, we have to do more than just be critical,” Moore says. “We have to develop the capability of influencing change as a consequence of our audit work. For example, if we are auditing a particular part of the bank where things are working well, we must determine how best to communicate those positive aspects of the operation so that they can be duplicated elsewhere. We must transfer the practices of the well-managed businesses to other parts of the bank.”



## EXPANDING THE ROLE OF AUDIT IN THE AUTOMOBILE ASSOCIATION LIMITED

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The Automobile Association Limited (AA) is the largest roadside assistance organization in the United Kingdom. Founded in 1905, the AA provides a wide range of services to millions of customers, including breakdown rescue and repair; insurance, finance and travel services; motoring advice; driving instruction; and publishing.

The AA and The AA Motoring Trust also provide expert knowledge and advice on motoring and transport issues, which are used by AA members, the public, safety experts and the government. The AA was previously owned by Centrica plc and was sold to private equity investors in 2004, transforming the AA into an independent business. The IA function is a corporate presence across the AA's business units.

Linda Chan has been the head of business assurance for the AA since April 2003. With an extensive background in internal audit and risk management, she oversees a team of five auditors who are responsible for protecting the assets of the AA and delivering value to audit clients in a number of ways. Chan reports to the chairman of the AA for broad strategic direction and to the finance director for day-to-day administrative issues.

Auditors join the function with the expectation to stay on the IA team for 18 months to two years. "Since we have a small team, each of our auditors is highly qualified with great potential to move on into operational and financial positions elsewhere in the organization," says Chan.

Chan looks for a variety of skills in auditors. "Our function is operationally oriented, rather than focused on finance," she says. "As a result, I try to gather a wide cross section of people on our team to maintain a balance and blend of talents and competencies. I want to maintain the credibility of the IA function by making sure people want to work with us, so I look for people with integrity and who work well with a range of different people. I look for auditors who are eager to learn new processes and systems and enjoy developing solutions to problems."

### *Objectives*

The IA team helps protect the assets of the AA by focusing on a comprehensive array of operational details, such as individual accounting transactions, as well as high-level strategic issues that affect the business. "We are consultants and partners for the AA's business units," Chan says. "We use specific methodologies and take a risk-based approach to auditing, dedicating our resources toward the high-risk areas we identify." In addition to targeting high-risk areas, the IA team reviews all of the business units on a rotational, three-year cycle.

The audit plan is based on a combination of factors that stem from consultations with directors, senior management, special requests from the business and previous audit history. Chan obtains input on business updates from reports that are issued to the board of directors and to which she has access. “I am kept up to date with changes that are going on in the business,” she says. “For example, one of the AA’s key strategies is to attract more members by offering discounts. By being aware of that strategy, the IA team can play a role, in this case by conducting reviews around our discounting policies and procedures.

“We focus on adding value to the organization in every way we can,” Chan says. “We draw on our team’s expertise, but if we are embarking on a specialized audit, we make sure to get the help we need to complete it effectively and efficiently.”

One of Chan’s primary objectives has been to improve the quality of the audit report, increasing its clarity and making sure that the team’s recommendations are pragmatic, realistic and achievable. “I want to make the audit reports as concise and easy to read as possible,” she says. “It is important to streamline the messages because our executives read every one of our reports. It is critical that we make an impact by placing key points in the beginning of the report. We want the content to be meaningful and we want the directors to continue to read and find value in our reports. The recommendations we make will improve efficiencies in the business, enhance the control environment and potentially save the AA money. This is what we want our audit clients to understand.”

According to Chan the IA reports historically focused on reporting exceptions, and while she and her team still point out exceptions and deficiencies in the reports, they also are careful to highlight areas of success to reward the efforts of the business units in improving their processes. This ensures future collaboration and support from the business units and helps to foster a positive working relationship between the IA function and the rest of the organization.

### *Performance measurement*

“We have certain KPIs [key performance indicators] that we have to meet in terms of the level of productivity and work to achieve,” says Chan. “For example, we are tasked with helping the organization save 10 million pounds by identifying errors and efficiency opportunities throughout the AA. We also are measured in relation to how many of our audit actions are cleared in a given time period. We monitor the AA’s clearance rate and score ourselves accordingly.” Additionally, the organization’s external auditors evaluate the quality of the IA team’s work, having to rely on it for their own roles and responsibilities. Finally, customer satisfaction surveys are sent out on an annual basis to audit clients to gather feedback on the perceived value of the audit, as well as the experience of working with the audit team.

Chan was eager to enhance the relationships between the IA function and the business units when she assumed her position. Historically, the internal audit team was larger and more traditional in nature, one that focused intently on checklists and financial compliance. “I was keen to help the IA group build a reputation of helping the business units move forward and substantially protect the AA’s assets. I spent significant time with directors and the senior management team to better understand their exposures, strategic needs and goals, so that the IA team could deliver real value to our clients,” she says.

## *Corporate governance*

The AA is in a unique position with regard to corporate governance issues. While the AA is not a foreign registrant and is not required to comply with Sarbanes-Oxley or any UK or European governance regulations, the AA recognizes the importance of good governance; therefore, compliance with governance requirements is an issue on Chan's mind. Moreover, her current role includes a governance aspect – as a corporate governance thought leader for the AA, she has responsibility across the organization to make sure that the business units understand the overall governance climate and what requirements may affect the AA in the future. She also is responsible for communicating these issues to the appropriate people in the organization.

“Around the time the AA was sold, Sarbanes-Oxley was emerging and we realized it was only a matter of time when there would be UK or European corporate governance requirements we would need to consider,” she says. “This actually fits well with some of my objectives for the IA function. Within the AA we had a shortage of documentation depicting an overview of processes and procedures. Once we developed a governance focus, the business assurance team and individuals in the business units began documenting key processes, following the COSO framework. The feedback we have received so far is very positive – even compared with companies that do need to comply with federal governance regulations, we are considered far ahead in terms of our documentation and testing achievements.

“We have dedicated a significant amount of effort to getting our key processes documented, and now the challenge is to keep them up to date. This year I will oversee documentation and make sure it is well integrated within each of the business units, since documentation will be owned by the businesses. I am currently training business unit leaders how to map processes and identify key risks and controls, as well as how to assess the efficacy of those controls.”

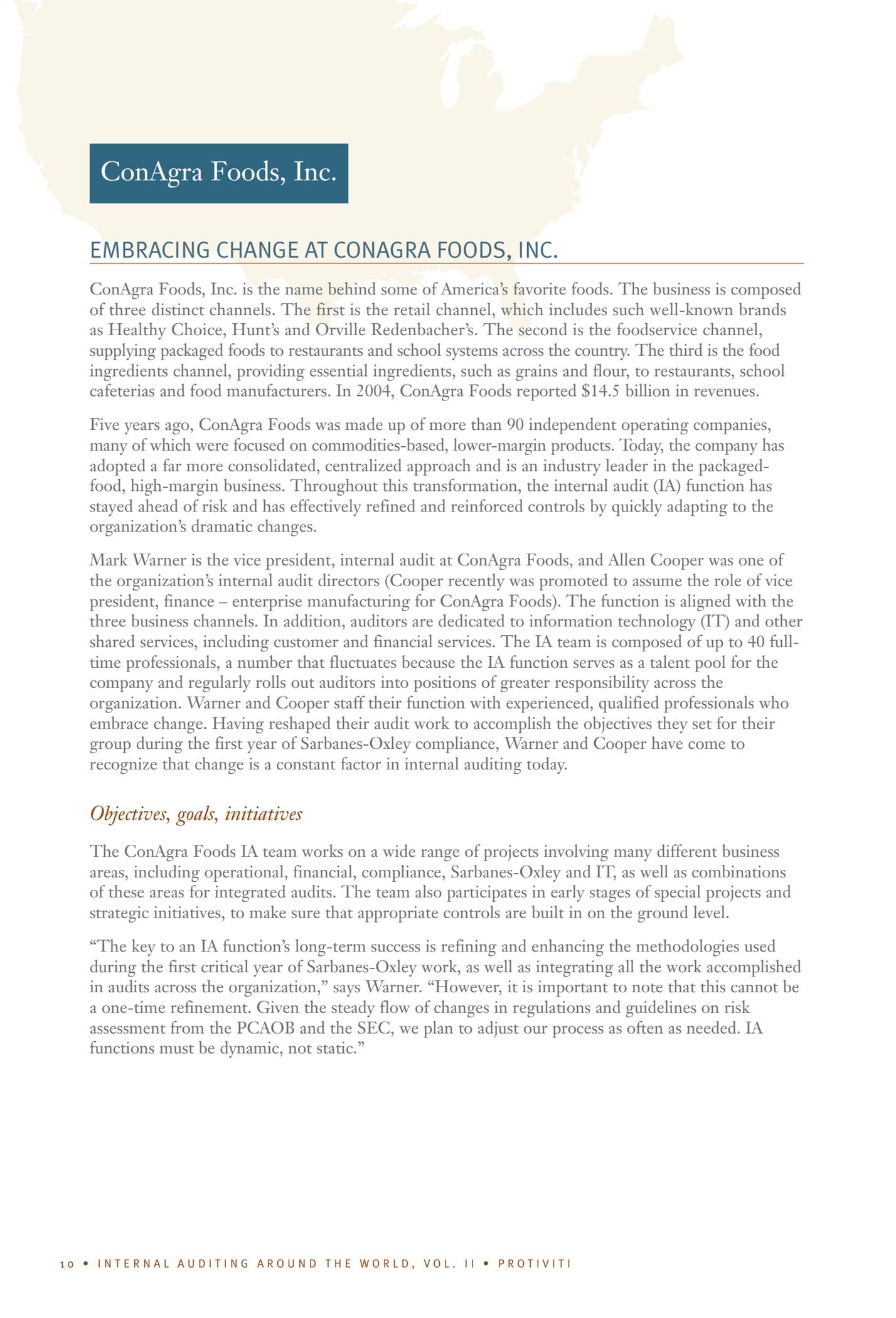
*“We are consultants and partners for AA's business units. We use specific methodologies and take a risk-based approach to auditing, dedicating our resources toward the high-risk areas we identify.”*

*– Linda Chan, Head of Business Assurance, AA*

## *Change and challenges*

The AA has undergone substantial change over the past 18 months from group ownership to an independent business. As a result, all of its shared services had to be separated. Another of Chan's challenges is ensuring that adequate controls are built into emerging systems and processes.

However, throughout the change and evolution of the AA, the IA function continues to be viewed as a value-adding group. Recently, the organization conducted an exercise in which it evaluated all central costs to decide what kind of services belonged in the AA's central function. The IA team was one of the groups whose numbers were not significantly affected in this evaluation. “We can keep our headcount and, in fact, I have been asked if we need additional staff,” Chan says. “It is an interesting time for the IA team. We are consultants and business partners, and I think that our new approach has created a far greater demand for our work. “

A light beige map of the United States is positioned in the background of the top half of the page. A dark blue rectangular box is overlaid on the map, containing the text 'ConAgra Foods, Inc.' in white serif font.

## ConAgra Foods, Inc.

### EMBRACING CHANGE AT CONAGRA FOODS, INC.

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ConAgra Foods, Inc. is the name behind some of America's favorite foods. The business is composed of three distinct channels. The first is the retail channel, which includes such well-known brands as Healthy Choice, Hunt's and Orville Redenbacher's. The second is the foodservice channel, supplying packaged foods to restaurants and school systems across the country. The third is the food ingredients channel, providing essential ingredients, such as grains and flour, to restaurants, school cafeterias and food manufacturers. In 2004, ConAgra Foods reported \$14.5 billion in revenues.

Five years ago, ConAgra Foods was made up of more than 90 independent operating companies, many of which were focused on commodities-based, lower-margin products. Today, the company has adopted a far more consolidated, centralized approach and is an industry leader in the packaged-food, high-margin business. Throughout this transformation, the internal audit (IA) function has stayed ahead of risk and has effectively refined and reinforced controls by quickly adapting to the organization's dramatic changes.

Mark Warner is the vice president, internal audit at ConAgra Foods, and Allen Cooper was one of the organization's internal audit directors (Cooper recently was promoted to assume the role of vice president, finance – enterprise manufacturing for ConAgra Foods). The function is aligned with the three business channels. In addition, auditors are dedicated to information technology (IT) and other shared services, including customer and financial services. The IA team is composed of up to 40 full-time professionals, a number that fluctuates because the IA function serves as a talent pool for the company and regularly rolls out auditors into positions of greater responsibility across the organization. Warner and Cooper staff their function with experienced, qualified professionals who embrace change. Having reshaped their audit work to accomplish the objectives they set for their group during the first year of Sarbanes-Oxley compliance, Warner and Cooper have come to recognize that change is a constant factor in internal auditing today.

#### *Objectives, goals, initiatives*

The ConAgra Foods IA team works on a wide range of projects involving many different business areas, including operational, financial, compliance, Sarbanes-Oxley and IT, as well as combinations of these areas for integrated audits. The team also participates in early stages of special projects and strategic initiatives, to make sure that appropriate controls are built in on the ground level.

“The key to an IA function's long-term success is refining and enhancing the methodologies used during the first critical year of Sarbanes-Oxley work, as well as integrating all the work accomplished in audits across the organization,” says Warner. “However, it is important to note that this cannot be a one-time refinement. Given the steady flow of changes in regulations and guidelines on risk assessment from the PCAOB and the SEC, we plan to adjust our process as often as needed. IA functions must be dynamic, not static.”

“Many times, IA teams focus on telling other business units how to improve. I think that with all the changes that have emerged due to Sarbanes-Oxley and the changing role of auditors, we have to turn the focus on ourselves so that we can effectively accomplish our goals. These days, we have much more on our plate, and that has created a challenge for us.”

Cooper agrees: “In terms of our audit professionals, our challenge has to do with the fact that we are a talent feeder to the organization, meaning we are always adapting to change by hiring, training, and developing new people, and then channeling them throughout the organization. Sarbanes-Oxley simply exacerbated this challenge, because everyone was looking for professionals with similar skills sets that include auditing and business experience and corporate governance expertise. We hire individuals who can participate as members of a team, but can also lead projects and are comfortable interacting with senior members of our management and leadership team. Most important, we look for people who understand and accept change.”

The IA team sets its objectives, goals, strategies and metrics at a department level. These objectives, which are approved by the finance organization and shared with the Audit Committee, include performance metrics used to measure the progress of the IA function. The metrics include report turnaround time, work paper finalization and employee turnover. Warner also uses client surveys to monitor auditor performance and interaction with business unit management.

### *The challenge of Sarbanes-Oxley*

During the first year of Sarbanes-Oxley compliance, it was decided that the IA function would serve as the project management office. “We took on the role of managing this project, and it was a project in that first year, separate and in addition to our regular audit work,” says Warner. “We followed a project management philosophy to understand the regulations and identify the problem that we needed to solve.”

The next stage involved interpreting how Sarbanes-Oxley compliance guidelines fit into the ConAgra Foods corporate governance environment. Both Warner and Cooper point out that ethical and stringent corporate governance practices always have been part of the culture at ConAgra Foods, an organization with clearly defined values and standards. “We felt from the beginning that Sarbanes compliance was not a matter of creating something where nothing existed, but rather an opportunity to demonstrate that we were already doing the right things,” says Cooper.

*“We hire individuals who can participate as members of a team but can also lead projects and are comfortable interacting with senior members of our management and leadership team. Most important, we look for people who understand and accept change.”*

*– Allen Cooper, Vice President, Finance – Enterprise Manufacturing, ConAgra Foods*



The IA team developed a methodology and then vetted this approach with management and leadership across the organization, establishing a process for several key steps:

- Documenting and testing compliance
- Choosing which processes and procedures to test
- Deciding where the tests should be performed
- Identifying the roles and responsibilities of the IA team, as well as management
- Determining the resources and staffing to be used
- Targeting deadlines
- Developing procedures for follow-up and re-testing

Warner and Cooper directed their team to work closely with the ConAgra Foods external auditor to make sure that all efforts were integrated as much as possible. Once the foundation was established, “it was all a matter of elbow grease,” says Cooper. In the end, ConAgra Foods met the certification requirements on time.

### *Ongoing challenges*

Like most IA departments, ConAgra Foods’ IA professionals always will contend with Sarbanes-Oxley requirements on some level. At the same time, they will continue to be responsible for operational, compliance and financial audits, as well as the increasing need to develop more thoroughly integrated audit processes.

“In the near term, our challenges are already on the canvas,” says Warner. “If you open the lens wider, you will see that ConAgra Foods, like every other business, is continuing to evolve and change. Our ongoing challenge is keeping up with those changes, whether they involve mergers, acquisitions, restructuring or automation. We must stay ahead of the curve and capture opportunities for the organization.”

Warner and Cooper agree that in striving toward becoming a world-class audit function, you never really get there. “As you climb the mountain, you can always see farther.”

## INTEGRITY AND CONTROL: INTERNAL AUDITING AT DAIMLERCHRYSLER

DaimlerChrysler is truly a global organization. With headquarters in Germany and Michigan, the company has 385,000 employees worldwide, including 215,000 in Europe, 124,000 in North America, 22,000 in Asia, 15,000 in Latin America and the remainder in Africa and Australia.

DaimlerChrysler produces vehicles ranging from small cars to sports cars and luxury sedans, as well as vans, heavy-duty trucks and coaches. The company's passenger car brands include Maybach, Mercedes-Benz, Chrysler, Jeep®, Dodge and smart. Commercial vehicle brands include Mercedes-Benz, Freightliner, Sterling, Western Star, Setra and Mitsubishi Fuso.

DaimlerChrysler's four main operating divisions with corresponding revenues are:

- Mercedes Car Group – 46 billion Euro
- Chrysler Group – 49 billion Euro
- Commercial Vehicles – 33 billion Euro
- Other activities, primarily financial services – 14 billion Euro

In 2004, revenues for DaimlerChrysler totaled 142 billion Euro. As a global company focusing on the activities in NAFTA and the rest on Europe, DaimlerChrysler has a matrix structure that includes board members and executive managers responsible for risk in the divisions listed above. There also are board members responsible for the following cross-functional processes:

- Financial and control
- Human resources
- Procurement and supply
- Corporate strategy, information technology management, communications, legal and corporate audit
- Research and technology

Hubertus M. Buderath is the vice president of corporate audit for DaimlerChrysler AG. "Overall, we have 10 board members," he says. "This is unlike the typical American board of directors. In Germany, we have the two-tiered board system consisting of the Board of Management, composed of executive management and the fully independent supervisory board, which controls the activities of the Board of Management. No supervisory board member has an operational role in the company."

In DaimlerChrysler's internal audit (IA) department, 225 professionals are dispersed in 23 global locations. The department is physically decentralized, but centrally managed through unique standards and procedures, overseen by the head office and Buderath himself.

"Of these 225 employees, 45 are Germans, roughly 100 are Americans and the rest represent nearly 20 other nationalities, including Japanese, Chinese, South American, South African and Brazilian. We are a culturally diverse team," says Buderath.

Originally, his aim was to centralize the company's internal audit organization in two or three locations worldwide. "It was intended to have people in Stuttgart, and Auburn Hills, Michigan, which is near Detroit, with a third central location in South America," he says. "However, this was unrealistic from a cultural standpoint. With increasing globalization, we were not able, from Germany and the U.S., to provide reliable IA work in all the countries we served. The language, letters, culture, laws and regulations became a barrier. Therefore, we decided to create more decentralized audit departments with a solid reporting line to the head of corporate audit."

Today, the IA department reports directly to the CEO of the company, and since 2003, when DaimlerChrysler introduced Sarbanes-Oxley legislation, the group also reports to the audit committee, which is a committee of the supervisory board.

### *IA skills must mirror the company*

Skill sets are important for Buderath, and he devised a seven-point checklist, which is not ranked in order of importance, to evaluate the qualifications of potential DaimlerChrysler auditors. Internal audit skills he is looking for include:

- Financial reporting, controlling and accounting skills
- Engineering abilities. "Today, DaimlerChrysler focuses on research and technology, and product development and design, which are both engineering activities," says Buderath. "We also focus on manufacturing and logistics, a mix of engineering and economic issues; therefore, engineering is an important aspect for auditors to be aware of and understand."
- Information technology and information management
- Forensic auditing experience and training
- Knowledge of important international laws related to internal auditing, international general legislation and compliance issues. "For example, the Foreign Corruption Practice Act is an important legislation of which auditors must be aware. Also, auditors need to understand the general regulations of nongovernment organizations, for example the OECD, the UN and Transparency International," says Buderath.
- Basic knowledge of other legal matters, such as civil law, labor law, etc.
- Analytical skills

"With respect to skills, other preconditions to engage auditors at DaimlerChrysler include language skills," says Buderath. "Our staff members must speak two languages: English and the language of those countries where we perform the most audits. In the U.S., this typically means English and Spanish. In Europe, it means English and German, French, Spanish, Italian and so on, and in Asian countries, Chinese, Japanese and other languages.

"The skills you need in an internal audit department depend on the activities of the company," he says. "I always use the following metaphor to describe my viewpoint on this: An IA department, with its culture, organization, structure, people and procedures, must be like a mirror of the company. If the company is changing, then the IA department must change as the picture in the mirror changes. Therefore, auditor skills depend on the activities of the company."

## *Mission and scope*

The DaimlerChrysler audit department's mission is closely aligned with that of The Institute of Internal Auditors. However, it also reflects the purpose and culture of the company: "Corporate Audit is an independent, objective assurance and consulting corporate function designed to add value and improve DaimlerChrysler's operations. It helps DaimlerChrysler to accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, internal control and corporate governance processes. Special tasks are the identification of risks concerning the realization of corporate strategies and covering risks regarding the image of the company and its governance body and to initiate appropriate actions."

The scope of the team is to determine whether the company's procedures with respect to risk management, internal controls and corporate governance processes are adequate and function in a way to ensure or to provide the following:

- Identification and management of risk, including risk concerning the integrity and image of the company.
- Interaction with various stakeholders, as needed.
- Inclusion of shareholders, the community, customers, employees, suppliers and nongovernmental organizations in the scope of corporate operations.
- Assurance that financial, managerial and operation disclosure is accurate, reliable and timely.
- Compliance of management and staff actions and behavior with policies, standards, procedures, and applicable laws and regulations around the world.
- Economic acquisition, efficient use and adequate protection of resources.
- Achievement of programs, plans and objectives.
- Fostering quality and continuous improvement in the organization's control processes.
- Implementation of recommendations for improvements and procedures to prevent waste, fraud and inappropriate behavior.

Both the mission and the scope enable DaimlerChrysler's audit team to achieve its strategic objectives of protecting the integrity and image of the company and supporting the development of a reliable and effective corporate governance process within the organization.

## *Internal audit methodologies*

"As a primary audit methodology, we use a Risk Oriented Planning Procedure (ROPP), a system that we improve from year to year," Buderath says. "One aspect of this system is our so-called 'Red Flags' process, which has been developed through experience and by benchmarking with other companies. Red Flags allow us to identify very critical areas, processes, projects and transactions that point to the efficiency of the company. It helps our audit team to decide on the audits they should perform."

Buderath and his team also use an electronic data processing-supported audit management system, which includes the audit planning process, as well as a systematic feedback process that is provided by the recipients of audit reports.

“Furthermore, we use a rating system for audit findings,” he says. “We rate all findings between A and E, the most important and critical are the A and B ratings. With this system, we can focus our activities and the activities of operational management and the Board of Management on very critical issues.

“We measure our performance, not on economic figures, but through this feedback and these ratings. Also, at the end of the audit report we establish actions, which have been agreed upon by operational management. We provide systematic follow-up procedures to determine the number of agreed actions that have been accomplished, and this is another performance measurement tool that we use,” he says.

The IA team provides the audit committee and the Board of Management with two detailed IA reports each year. These reports include an overview of internal controls, corporate governance and compliance issues.

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*– Hubertus M. Buderath, Vice President of Corporate Audit, DaimlerChrysler AG*

### *Sarbanes-Oxley*

Buderath and his team operate a Business Practice Office (BPO) within DaimlerChrysler, an office that was established along with the emergence of Sarbanes-Oxley regulations, that states as a foreign private issuer, DaimlerChrysler must establish visible audit procedures. The BPO assists in this goal and uses two locations in the United States and Germany.

The BPO receives all allegations of inappropriate practices, such as fraud, including any form of bribery, theft, conflicts of interest, sexual harassment and discrimination, with respect to professionals both inside and outside the company. The BPO will monitor any ensuing investigation and decide which department should oversee the investigation. Often, that role falls to the forensic auditors in the IA department, but other departments are also involved, including corporate security, legal and human resources.

“Last year and this year, internal controls self-assessment processes were performed by operational management of different divisions,” says Buderath. “The role of IA is to monitor the process and review results. In addition, IA monitors the quarterly certification process of financial reporting.”

### *Challenges ahead*

“In the near future, we plan to further improve our corporate governance procedures and use the role of the IA function to help the company enhance its reputation, integrity and shareholder value,” Buderath says. “We plan to transfer Sarbanes-Oxley procedures into normal business activities and accounting processes. We will continue to monitor these procedures on a broad basis.”



## RAISING THE BAR ON AUDIT PERFORMANCE AT EIRCOM

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eircom is Ireland's leading provider of telecommunications, providing a comprehensive range of advanced voice, data and Internet services. The company, formerly known as Telecom Eireann, was established in 1984 when it became a semi-state company. In July 1999, the company was listed on the Irish, London and New York stock exchanges. In May 2001, eircom completed the demerger of its mobile telecommunications business, Eircell, which was purchased by Vodafone. In November 2001, eircom plc was purchased by Valentia Telecommunications Ltd. and subsequently delisted from the Stock Exchange in December 2001. eircom returned to the Dublin and London stock exchanges in March 2004 and recently has returned to the mobile market following its acquisition of Meteor.

Brendan Darcy is the group head of internal audit (IA) at eircom. He has worked in the internal audit field for more than 17 years in both the public and private sectors, acting as head of internal audit in a number of organizations, including RTE, the Marine Institute, the Department of Transport and on special assignments to a number of European plcs. Darcy's experience includes seven years as a KPMG consultant, specializing in benchmarking client IA functions against best practice.

When Darcy joined eircom in May 2005 his objectives included introducing a robust IA function and helping to achieve Sarbanes-Oxley compliance by providing an internal quality assurance review process for the project. He also acts in an advisory capacity, given his experience related to Sarbanes-Oxley. As eircom enters its first year of compliance, Darcy currently is involved with a number of initiatives to assist internal management and the external auditors to test specific control processes.

"The IA function at eircom was originally perceived as a police-like function in line with the now defunct definition of internal audit," Darcy says. "The role in the past essentially focused on identifying problems and exposures, rather than helping to mitigate risks and manage them. It is my intention to ensure that my team of 12 auditors takes on a more advisory and consulting role for the eircom group. As has been evident elsewhere, this task of moving to an in-house control advisory and consultancy function, as opposed to pure assurance, can be difficult since IA has to balance various roles, including fraud investigation, to achieve the best blend for the business. The optimal way to prove our worth as well-positioned and competent advisors to the business is to constantly look for ways to deliver value."

The company is divided into a number of divisions, such as finance, human resources, operations, retail, wholesale and mobile services. A senior executive sits at the head of each of those divisions. The IA function is structured along the same lines, including financial, operational and information technology (IT). Darcy reports to the audit committee and sits on several other committees, such as the risk committee and the corporate governance committee.

"The IA role has changed significantly within eircom," he says. "At the beginning of my term we were firefighting. We have now moved to a strategic approach, looking at end-to-end processes and using a themed audit approach by examining integrated processes from beginning to end."

In addition to his own team, Darcy works with a number of departments that also are dedicated to internal control improvements. These include the Sarbanes-Oxley project team, as well as the revenue assurance, regulatory compliance, risk management and group tax functions.

## *Staffing strategies*

When junior-level auditors join the IA function, they are placed in one of three groups – finance, operations or IT. They eventually move toward a senior-level position within the function and over time proceed to manager level. “Once they have reached and adequately served at the manager level for two years, the auditors are encouraged to move into the business,” says Darcy. “I see the IA function as a breeding ground for senior managers of the organization. My idea is to turn over staff relatively quickly for a number of reasons, including the need to bring ‘new blood’ into the function, renewing the staff and ensuring the influx of new ideas. Another and significant benefit to this approach is that staff coming from IA have an excellent understanding of the business, a great advantage for the central functions. This was an approach to internal audit staffing I originally witnessed in the BBC in the mid-1990s and I have tried to introduce it everywhere I have worked since then,” says Darcy.

When Darcy recruits externally, he tends to target the Big Four auditing firms because he seeks individuals who are proficient not only in external audit, but also client service delivery. “These professionals come with important soft skills, such as the ability to negotiate, communicate and present effectively. I place a high value on these skills, particularly when trying to achieve my stated aim of moving the function towards an internal consultancy role. Some of my strongest performers do not come from an external audit background, but have the necessary ‘life skills’ to meet the needs of the function, as well as the obvious business experience.”

Darcy also recruits a portion of his staff internally, believing it to be one of the best ways to recruit operational auditors. “It is very difficult to find anyone with the necessary telecommunications-related technical experience in the general market, hence we have a comprehensive internal recruitment program. For those individuals that I recruit internally, I make sure they follow a thorough IIA-based training program that stresses these skills as well,” he says.

## *Mission*

The IA function’s mission statement says that the team is “committed to adding value and improving eircom’s operations by bringing a systematic and disciplined approach to its work in the evaluation of internal controls and management of risk when assisting the company to achieve its objectives.”

The purpose of the IA function is to:

- Give assurance to the audit committee, CEO and board on the adequacy, application and effectiveness of the company’s internal control system including risk management and governance processes.
- Assist management by reviewing the elements of the internal control system for which they are responsible and act in an advisory capacity when assessing the need for remediation and provide performance improvement observations where appropriate.

“Our primary aim is to advise and assist the business,” Darcy says. “For example, if a line of business is concerned about a possible risk or control issue and they approach IA for an independent review or comment, that is not regarded as an opportunity for a ‘caught you’ style audit report, but rather for one-on-one advisory service leading to remediation or process improvement by management. First and foremost, we are here to add value.”

To achieve this mission, the IA function develops an annual audit plan that is based on a risk and control matrix. This matrix is built on four key drivers:

- The first driver is each business line's Risk Identification Process, which identifies risks and their likelihood and impact as prepared by local management.
- The second driver is the internal audit risk-assessment process, in which risks are evaluated by reference to "heat maps" where organizational impact is assessed without the need to evaluate the significance of individual business silo risks.
- The third driver stems from the close working relationship between the IA and external audit teams. This is where Darcy and his team assess the management letter points produced by external audit over the previous three years that identify recurring themes for inclusion in the IA annual audit plan.
- The fourth driver comes from the business itself. IA regularly seeks input from senior management, the Sarbanes-Oxley compliance project and regulatory compliance functions in the form of audit requests.

After each annual audit plan is created, the IA team focuses on individual audit programs. "We go back to square one," says Darcy. "We examine the impact for the area we are auditing and for the company as a whole. We look at financial, reputational and operational risks and produce a standard, documented audit plan. Final deliverables include a risk rating between one and four in terms of impact on the company. This enables us to produce a succinct and meaningful audit opinion for the audit committee.

"The one-to-four scale is an issue close to my heart," he says. "Too often, when benchmarking internal audit functions, I saw the application of three-tiered scales – for example, high, medium, low or red, amber, green. When discussing the significance of a risk and trying to agree on the relevant rating to be presented to the audit committee, it is easy to gravitate towards the middle ground. In one function every risk I reviewed over a three-year period was rated medium, which effectively told the audit committee nothing. Our approach with the one-to-four scale generates debate when finalizing reports, but it proves its value when reporting on the significant or real issues to the audit committee."

### *Benchmarking*

Performance measurement is a critical component of Darcy's management approach, and it is built on comparisons to best-practice and peer-group benchmarking. At KPMG, Darcy specialized in benchmarking client IA functions against best practice. For eircom he has applied the same process with an evaluation of the function under the following headings:

### *Positioning*

- Drivers and mission
- Customers and service
- Organization and structure
- Funding
- Success criteria

## *People*

- Competency
- Staffing and strategies
- Career development and progression
- Culture
- Reward

## *Process*

- Planning and delivery
- Technology
- Administration
- Performance measurement
- Relationship management

“We score the IA team’s performance against best practice, which I regard as the IIA standards, and against data available from a relevant peer group under each heading,” says Darcy. “Although we aspire to be the best internal audit function in the telecommunications industry, and this can only be measured by reference to our peer group, we must be the best IA function for eircom, and this can only be assessed by quality feedback from our stakeholders – the audit committee and the business.”

To obtain the relevant feedback, Darcy and his team circulate questionnaires that require an IA team rating for well-defined performance criteria. The questionnaires also are sent to eircom’s external auditors, as well as the audit client or business area reviewed. The IA team gathers the feedback and reports results to the audit committee on a quarterly basis.

## *Corporate governance*

While he is heavily involved in corporate governance issues, sitting on a number of committees that focus on enterprisewide risks and governance issues, as well as providing assurance and the effectiveness of internal controls, Darcy is not directly involved with Sarbanes-Oxley efforts.

“I am removed from the Sarbanes-Oxley compliance program,” he says. “In our IT group, there are a number of professionals dedicated to Sarbanes-Oxley compliance on secondment to the program, and I estimate that 60 percent of the IT group’s time was spent supporting the program leading up to December 2005. This is simply due to the scarcity of adequately qualified IT auditors in the market. Additionally, we support the program through our normal work where IA reviews are regarded as independent assessment or testing on behalf of management. We also provide a quality assurance review of the project and work with external audit to achieve a no-surprises approach to the final assessment.”

As for challenges ahead, Darcy believes the function has proved its worth in terms of the production of quality deliverables. This must be closely managed if it is to be maintained, so the next phase in the development of the IA function will be to increase the quantity and coverage of IA activity.



## COURAGE AND WISDOM: THE BYWORDS OF AUDITING AT JAPAN TOBACCO INC.

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Japan Tobacco Inc. (JT) is one of the world's largest tobacco manufacturers. The company's Operational Review & Business Assurance Division seeks auditors who can grasp the big picture with clarity and open-mindedness.

JT has two-thirds of the cigarette market in Japan, making it the third largest international tobacco manufacturer in the world. JT sold almost 430.7 billion cigarettes with a total net sales of US\$43.4 billion during the fiscal year that ended March 31, 2005.

Since its privatization in 1985, the company has diversified into pharmaceuticals, and food and beverage, employing about 8,290 people in the company's nontobacco operations, and 24,350 employees in the tobacco business within the JT group.

The company's tobacco business is divided into two divisions: domestic and international. While the profit from domestic cigarette sales is significant, the recent growth of the international cigarette business has led cigarette sales volume overseas to surpass those in the domestic market. International headquarters is in Geneva, and its shareholding and governance company is in the Netherlands. Other headquarters functions for JT are located in Tokyo.

Nobuhiro Hayamichi is the chief of Internal Audit, which consists of a department in Tokyo called the Operational Review & Business Assurance Division (ORBA) that oversees domestic cigarettes, foods, pharmaceuticals and corporate operations, and another department in the Netherlands called JT International Internal Audit, which is responsible for international business. With the introduction of modern auditing theory, typified by the COSO Framework and risk-based auditing methodologies, JT's ORBA was established July 2001.

Today, the division is composed of 20 audit professionals who work in five teams:

- Planning
- Audit 1
- Audit 2
- Environmental/IT
- The Board of Audit of the Japanese Government

The Internal Audit Division in JT International Holding, which is a holding company for 90 international tobacco subsidiaries excluding China, is located in the Netherlands. This team is made up of 16 professionals of eight nationalities, all of whom report through the leader of the division to Hayamichi and the chairman of JT International Holding.

### *Internal auditor skills*

Key skills for internal auditors include the ability to assess a situation accurately, identify solutions quickly and communicate persuasively. According to Hayamichi, other vital skills include self-discipline and a proactive attitude. "The two most important things I look for in internal audits are

wisdom and courage,” he says. “Wisdom means knowledge of the business and the ability to both grasp the total picture while operating with the perspective of management in mind. Courage is the ability to speak what is right without hesitation.”

Employees in many Japanese corporations enter organizations after graduating from university and are typically assigned to various operational divisions. At JT, when employees complete their first assignments after two to three years, the human resources department and Hayamichi’s team discuss the potential of each employee. “We look for management and leadership talent,” says Hayamichi. “The ORBA Division is one option for those with management potential. They would work for our team for approximately three to five years as an internal auditor before being assigned to a management position.”

JT’s international business approaches hiring and retaining employees differently. The 16 professionals who work in the Netherlands are recruited from around the world because the audits they perform focus on international businesses. These individuals work with the audit team for five years before being transferred to operational positions in business units worldwide.

“With regard to human resource development, our division provides candidates for the future management positions throughout JT,” Hayamichi adds. “We hire young, talented individuals, train them thoroughly and transfer them to other divisions within approximately five years. I think this is unique among Japanese companies. In my opinion, our division could be called the ‘School of Management’ as several CFOs in local markets and key personnel in headquarters are former internal auditors at JT.”

*“The two most important things I look for in internal audits are wisdom and courage. Wisdom means knowledge of the business and the ability to both grasp the total picture while operating with the perspective of management in mind. Courage is the ability to speak what is right without hesitation.”*

*– Nobuhiro Hayamichi, Chief of Internal Audit, Japan Tobacco Inc.*

### *Audit goals and methods*

The mission and strategic goal of JT’s ORBA Division is to be a governance partner for management and the organization, and help enhance corporate value by performing the following tasks:

- Analyzing and evaluating the internal controls or risk management system in operating divisions throughout the organization
- Providing value-added advice and assurance
- Managing risk

The methodology Hayamichi follows is “textbook style” auditing that applies best practices recommended by The IIA and audit textbooks. He and his team use a top-down risk approach to develop annual audit planning. They begin with management interviews focusing on the input from the president and vice presidents of operating divisions. The auditors lead discussions based on a draft proposal presented by the audit team. “This proposal prioritizes a midterm corporate business plan, taking into consideration the internal and external business drivers, requests from operating divisions and financial data,” says Hayamichi.

Individual audits are implemented through a project management system in which project leaders are assigned tasks, such as scheduling, setting dates for approvals and making key decisions. Advance analysis is conducted before embarking on field work. Throughout the audit assignment, meetings with management take place at regular intervals during which risks and controls are identified and the COSO framework is followed. Other meetings throughout the audit process include an opening meeting, which outlines the audit objectives and purpose, and identifies those responsible for establishing and maintaining internal controls. The closing meeting confirms findings and helps communicate opinions.

“Findings, risks and recommendations are made by our team and these also incorporate counter-comments by the auditee,” says Hayamichi.

After each audit is complete, questionnaires are given to auditees as a way of gathering feedback on performance. The questionnaires include broad questions, such as attitudes of auditors, quality of communication, feasibility of recommendations and evaluation of the audit itself in terms of business value. “This feedback is used for maintaining the quality of our auditing service. The results are included among our division’s Key Performance Indicators (KPIs),” says Hayamichi.

“In Japan, KPIs are established each year according to the conceptual framework of the Balanced Scorecard,” he says. “The president of the company evaluates KPIs with regard to audit planning, performance and the level of business support supplied to each operating division. In the Netherlands, KPIs are aligned with the goals of the international operations, based on the concept that the audit team shall contribute to the KPIs of the total operation.”

### *Forging relationships*

Hayamichi views his team members as business partners who provide services of assurance or recommendations to improve the quality of management and governance. “So far we received a certain number of requests from unit managers for auditing their operations and for helping to develop effective governance methods, as well as risk management,” he says.

The ORBA Division plays a key role in JT’s overall corporate governance approach. “We help manage risks related to corporate governance through selecting themes in annual audit planning and by implementing each audit assignment steadily, with the recognition of our role of independent monitoring,” says Hayamichi. “However, we know that our current activity is not enough to support top management. Some governance gaps may exist. It is our obligation to closely monitor the best practices of other companies and to recommend the implementation of mechanisms necessary to strengthen our corporate governance at JT.”

### *Two key challenges*

The two primary challenges facing Hayamichi and his division are changes in governance regulations and recent information technology developments.

“We are making preparations for a corporate governance act pending in Japan that is similar to Sarbanes-Oxley, sometimes referenced as ‘J-SOX,’” says Hayamichi. “The law will be effective as soon as 2008. I recognize that this is an excellent opportunity for us to establish an effective control framework and corporate culture at JT with regard to sustainable governance strategies. However, we still need to ascertain the guidelines, project structure and how we will implement these changes without significant disruption to the business. We also want to understand how to create synergies between monitoring activities under J-SOX and assurance and recommendation services.”

At the moment, Hayamichi has appointed some staff to a cross-functional team responsible for providing related information and advice.

The second challenge is to increase internal audit competencies and certifications surrounding fraud and information technology auditing. “We are beginning to study and acquire certifications, such as Certified Fraud Examiner and COBIT,” says Hayamichi.

Overall, the most important challenge for Hayamichi is to continue to groom auditors who will display the courage and wisdom to do the job well, with the clarity and open-mindedness that enables them to truly perceive the total business landscape.



## INTERNAL AUDITING AND OPERATIONAL EFFICIENCY AT NATIONAL BANK OF CANADA

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National Bank of Canada, founded more than 140 years ago, is the sixth largest chartered bank in Canada. As an integrated financial group, National Bank provides comprehensive full-service financial services to consumers, small- to medium-sized companies and large corporations in the province of Quebec, while offering specialized services to customers outside of Quebec. National Bank currently services about 2.5 million retail clients and operates an extensive treasury division that deals in all segments of global markets, foreign exchange, commodities and derivatives.

National Bank also owns an asset management company and two mutual fund companies. Headquartered in Montreal, National Bank employs 16,900 professionals who operate a network that spans 457 branch offices and 788 ATMs, with nearly \$108 billion in assets and a market capitalization of nearly \$10 billion.

### *Creating synergies in operational structure*

The operational structure of the organization is mirrored in the structure of the bank's internal audit (IA) function. National Bank has three major lines of business: retail banking, commercial banking and National Bank Financial, which is the institutional and brokerage division.

The retail banking division focuses on personal clients and includes wealth management, mutual funds, product manufacturing, sales and distribution. This division also provides clients with life, car and home insurance through a partnership with a third-party insurance provider.

National Bank's commercial banking division provides commercial banking products and solutions to businesses in Quebec and in selected niches outside Quebec. In Quebec, National Bank is known as the bank most committed to the small- and medium-sized enterprise market. Outside Quebec, its main focus is on emerging businesses in the primary sector and service enterprises in the energy industry.

National Bank Financial (NBF) is the investment banking arm, or broker dealer, of the National Bank. NBF is a leading Canadian full-service investment bank, with origins dating back to 1902. NBF has more than 3,400 employees with offices and operations in Canada, Switzerland, the United States and the United Kingdom. The firm offers financial services and products to private and publicly owned corporations and institutional investors, individual investors and government agencies. NBF has more than 86 retail offices across Canada and is the dominant provider of third-party brokerage services in the country.

Other corporate divisions within the organization deal with risk management, human resources and operations, and finance and corporate affairs. The risk management division, which is fully separate from the IA team, proposes risk management policies, implements tools to identify, measure and monitor risk, applies independent review and risk approval procedures, sets risk limits that reflect the risk tolerance established by the board of directors and informs the bank's management and board of significant risks. This division is responsible for all types of risk that may impact the business, including operational and reputation risks.

The human resources and operations divisions have two distinct missions. For human resources, the objective is to be a proactive partner in implementing business strategies and a facilitator in the cultural evolution of the bank. In the operations sector, the goal is to be recognized by the business lines as a center that uses world-class operational practices at optimal cost.

Finally, the finance and corporate affairs division oversees accounting, finance, capital management, legal affairs, corporate security, internal audit, corporate secretary, compliance activities, and marketing and public affairs.

Olivier Lecat is the senior vice president of the IA team at National Bank. He has held this position for four years, with 16 years of experience in internal auditing. The bank's IA team consists of 87 professionals and management officers, all located in Montreal. Among the 87 team members, 11 are charged with supporting IA policies, procedures and quality assurance and providing technical support to the department. A group of 29 professionals, focused on corporate security and anti-money laundering (AML), is separate from IA.

Functionally, Lecat reports to the audit committee chair, and administratively he reports to the senior vice president of finance, technology and corporate affairs. The audit committee chair approves the IA annual plan and mission statement and reviews the level of audit resources needed to carry out the plans that have been submitted for approval. The audit committee is presented with quarterly summaries of audit work, including an overview of key issues and a summary report. The audit committee also is given an annual detail report that outlines the work the IA team has performed throughout the year and an annual audit opinion as to the effectiveness of controls throughout the organization.

"I have direct access to external auditors and regulatory bodies," Lecat says. "Financial institutions in Canada are rigorously overseen by regulators. I also have direct access to the audit committee; beyond regular meetings with the chair of the audit committee, I meet privately with him before submitting our quarterly reports."

### *Seeking a wide range of auditing skills*

The skills Lecat looks for in internal auditors depends on the specific group in which the auditor will eventually work. For example, the treasury audit group is staffed with auditors who have trading expertise, treasury risk management experience and operational skills.

This group also includes individuals with the quantitative skills necessary to understand models and valuation algorithms.

In the audit group dedicated to the retail banking division, Lecat has placed auditors with backgrounds as account managers or client service officers. The commercial group includes former account managers and individuals with credit risk expertise. The finance and accounting group is staffed by auditors with accounting certifications. The brokerage audit group has employees with retail brokerage experience. In the corporate function and processes audit group, the auditors specialize in process analysis and mapping. Lastly, the IT audit group includes individuals with a variety of skills, such as access controls, distributed technology, mainframe technology and project management skills.

"We look for auditors who are team players," Lecat says. "We emphasize teamwork because our audit approach is based on integrated audits. This means we deliver audit assignments that include a variety of different skills aligned against the mandate. For example, we may have technology, credit, operations, accounting and finance auditors who all have to work as a team on a given assignment."

Finally, Lecat explains that he seeks auditors with excellent oral and written communication skills. "We have high standards with respect to the quality of our audit reports," he says. "We use report templates and have designated targets for report length."

“We work hard to ensure that we have adequate skills within our organization by providing extensive training opportunities to our staff,” Lecat says. “We encourage our management and senior audit staff to have a certification and we continue to raise the bar with respect to competencies and expertise.”

### *Identifying strategic objectives*

The primary objective of any audit team is to provide an annual assurance to the audit committee regarding the efficacy of controls. An added objective at National Bank is that the IA team must deliver value to the organization by facilitating operational improvement and promoting best practices across the enterprise. “We recommend solutions to improve control efficiency in the organization,” Lecat says. “We are sensitive to this value-adding aspect. We try to maximize the synergies with our internal and external partners, and we work closely with external auditors to avoid duplication. We also collaborate with Canada’s regulatory agency that oversees financial institutions, the Office of the Superintendent of Financial Institutions. Internally, we work closely with our risk management division, corporate compliance and Sarbanes-Oxley groups to actively ensure that we are compliant with laws and regulations.”

Bill 198 is the Canadian equivalent of Sarbanes-Oxley, the only significant difference being a phased-in implementation based on company size. Bill 198 will come into full effect in 2007, and within National Bank, the senior management of the finance department leads this project. “They have a central team that enhanced the methodology to document controls. The information technology group is responsible for IT aspects,” says Lecat. “Our role is to support the development teams, conduct audits as we go along – for example, an audit of the documentation methodology – and provide counsel and advice.

“We are not driving the project, but we are participating in the testing of controls and the training of the risk officers in the bank’s business lines who will conduct some of the tests and update the documentation on an ongoing basis.”

### *Dividing the bank into entities*

In order to provide risk and control coverage in an organization with as many operational and functional divisions as National Bank, a system was needed to segment the business areas for adequate focus. The decision was made to “slice” the bank into sub-components called entities, which may be processes, systems, units or projects. Currently, National Bank has approximately 200 entities at the higher level, which are carefully reconciled to other sources of information, and the IA team conducts an annual evaluation of 14 risk factors, which are aligned with the Basel definitions:

- Strategic
- Credit
- Market
- Reputation
- Employment practices and workplace safety
- Internal theft and fraud
- External theft and fraud
- Process failures
- Regulatory risk

- Client disputes
- System failures
- Damage to physical assets
- Contractual commitment with third parties
- Financial integrity

Additionally, the IA function focuses on three key control factors in each business unit it audits. These three factors are tone at the top, senior management concerns and risk management effectiveness.

“We determine a priority ranking that dictates the frequency at which audits are conducted,” Lecat says. “High-priority areas are audited within 18 months, medium-priority areas are audited every 36 months and lower-priority areas are audited at the maximum of every 60 months, with limited exceptions.

“IA evaluates those factors annually, and senior management also reviews them to ensure they are comfortable with the audit priority assigned to each area. We also review the business area audit as soon as it is completed so that we update our evaluation immediately, and we regularly examine the way in which we split the bank into the entities, to make sure we maintain a comprehensive view of the organization as a whole.”

### *Measuring performance*

A quarterly scorecard helps measure IA performance by tracking 20 to 25 items in four categories:

- Operational targets
- Client satisfaction and added value
- Human resources and training
- Best practices and innovation

“We track these items to make sure we are in line with the targets that we set for ourselves,” Lecat adds. “We also benchmark against external organizations such as other Canadian banks, as well as surveys and reports.” Annually, the audit committee completes an evaluation questionnaire rating IA performance with regard to the quality of audit recommendations and coverage.

### *Building relationships*

The relationship between auditors and senior management at National Bank is highly collaborative while its necessary independence is maintained. “I have regular meetings with all the members of our senior management team on a one-on-one basis,” says Lecat. “We discuss key issues that surface during the quarter or audit recommendations that remain unclosed as of the meeting date, to make sure proper attention is given to significant issues. I believe in forging a close relationship with management to maintain a consistent level of information exchange.”

In the future, Lecat and his team face the challenge of continuing to recruit top talent in a highly competitive environment, made even more so by Sarbanes-Oxley and Bill 198. “We also want to continue to develop the technical tools we need to enhance our databases to deliver accurate and timely information, with the goal of facilitating continuous auditing.” In addition, Lecat intends to continue to improve skills and expertise in the group and provide value-added service to the organization.



## RAYTHEON COMPANY – CREATING POSITIVE CHANGE WITH A SENSE OF URGENCY

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Raytheon Company is an industry leader in defense and government electronics, space, information technology, technical services, business aviation and special mission aircraft. The company employs 80,000 and reported \$21.9 billion in sales for 2005. Approximately 80 percent of sales are generated within the United States, and the company, headquartered in Massachusetts, is organized into seven business segments. Raytheon, like the industry in which it operates, is dynamic, and therefore managing change is a constant challenge.

In 1999, Raytheon outsourced its Internal Audit (IA) function. However, when William H. Swanson became Raytheon's chairman and CEO in 2003, he recommended to the Audit Committee that Raytheon in-source the IA function, using co-sourcing where appropriate. The Audit Committee agreed to this strategy, and in the third quarter of 2004, Larry Harrington was hired as the vice president of internal audit to re-establish the function, marking the beginning of a new era of internal auditing at Raytheon.

“The new IA function has been built on the same principles that Raytheon uses to achieve its vision of being the most admired defense and aerospace systems supplier in the industry,” says Harrington. “This vision requires Raytheon, and its IA function, to be customer focused by driving performance, relationships and solutions through a set of values, which include people, integrity, commitment and excellence.” The result is what Raytheon calls Mission Assurance, the objective of which is giving customers the assurance of the quality and reliability of Raytheon products.

### *The benefits of in-sourcing and co-sourcing*

Raytheon's CEO and Audit Committee shifted from the outsourcing approach for three reasons:

- The IA function should be a company talent pool that attracts internal candidates to rotate into the function for a few years to learn about controls and expand their knowledge of company operations. The function also should attract external talent who will develop their business and leadership skills to fill future company roles, or, in some cases, consider internal auditing as a career. “Total outsourcing does not provide these human resource benefits,” says Harrington.
- Without a cadre of full-time, dedicated professionals, an IA team will not possess the vital knowledge of the company, including its business operations, risks and controls. Knowledgeable, full-time auditors build relationships and create networks throughout the organization, constantly adding value to the business.
- From a cost standpoint for larger companies like Raytheon, the skills to perform routine audits are less expensive to “own,” while specialized auditing is more cost-efficient to “rent.” According to Harrington, this is why co-sourcing is the optimal solution.

“There are so many advantages to co-sourcing,” Harrington says. “For example, IA functions perform fraud risk assessments, yet few auditors are fraud experts. Co-sourced subject matter experts help us think through fraud risks across the company and on each audit. These experts play critical roles on audits impacted by government regulations, or operational audits, such as information technology or insurance operations. They provide expertise on GAAP in more complex areas, such as income taxes or derivatives. With regard to non-U.S. audits, they allow us to reduce travel costs and take advantage of local language, cultural and statutory expertise. Finally, co-sourced subject matter experts provide access to best practices to share across Raytheon. It is critical that the co-sourced individuals understand the company and our culture and perform seamlessly as part of the Raytheon team.”

The IA function co-sources 20 percent of its resources. “This gives us the balance of subject matter experts we need to be a world-class audit organization and assists us in getting to root causes and sharing best practices across the company,” says Harrington. “It also allows us enough employees to build a full-time base of individuals who can truly learn all facets of our company, including its risks, opportunities and controls. Co-sourcing establishes the audit team as an essential talent pool and knowledge resource to help business segments achieve their goals and objectives by adding value on every audit. Finally, it provides the best position to support the Audit Committee.”

Harrington says that industry comparisons and the IIA Gain survey suggested the total resources for Raytheon’s IA team should be 60 full-time equivalents. He has already hired 37 full-time auditors with impressive backgrounds: 50 percent have MBAs, 75 percent are certified (CIA, CISA, CPA or Six Sigma) and many are individuals who are attracted to a company that recognizes the value and strength of diversity. “While we expect people to stay within IA for two to three years, business segments already hired four of our talent pool to fill critical needs that developed within their organizations, thus reinforcing a key reason for developing IA as an in-house function.”

Attracting talent in the competitive auditor job market requires the IA function to differentiate itself. According to Harrington, salary and benefits are important, but today it is also important to balance work-life issues, to implement reward and recognition programs and to make training and career development the centerpiece of a program. “New hires enroll in a career development program to identify capabilities and learning opportunities, and to articulate how they plan to direct their career in Raytheon. We developed a competency model, with training plans to support that model, which provides more than 300 hours of company training in the first two years. Investing in development and career goals is less expensive than turnover outside Raytheon.”

### *Auditor skills*

The majority of Raytheon’s auditors have six or more years of experience in internal or external auditing, engineering or other aspects of business. Beyond that, there is a range of skills Harrington seeks in his team. “We want people who understand business, risk and opportunities,” he says. “Our auditors must have outstanding verbal and written communication skills and possess the ability to create positive change. We want people who are comfortable networking throughout the company, building relationships with individuals at various levels, and persuading and convincing them that we are here to help and add value through audit work.”

Harrington emphasizes the importance of preventative rather than detective controls that are established up front – not after the fact. He believes that the IA team should help business units think through the process flow for each new system introduced in the organization. “Some companies implement new systems without realizing there may still be too many manual controls in place,” he says. “Sarbanes-Oxley enabled companies to recognize that increased automation of controls helps decrease errors and lower the cost of compliance. Sarbanes also highlights the need for integrated auditors who understand business, controls and technology.”

Harrington says that many IA shops are proficient at identifying symptoms, but not root causes. Raytheon embraces Six Sigma and has trained more than half of its employees on Six Sigma techniques. Auditors, who typically use a highly audit-centric language, have reached out to Six Sigma professionals to learn the language as well as the tools. “We have hired a Six Sigma expert who is working with us to transform the audit methodology and language to align with Six Sigma language and tools,” Harrington says. “This way, when we talk to customers we can use language they are comfortable with, as opposed to audit language, which may be unfamiliar to them. Six Sigma tools help companies get past symptoms all the way to root causes, and I believe it can revolutionize the value of auditing by helping us identify root causes and improve the efficiency and effectiveness of our operations.”

Most importantly, Harrington is looking for people with a sense of urgency. The motto of his team – “Creating positive change with a sense of urgency” – stems from the idea that in many cases it takes too long for audits to be completed, reports to be issued, and change to be created. “We want people who understand that a sense of urgency is a drive toward completion so that implementation of root cause solutions can be expedited,” he says. “Creating positive change for the business means helping people improve their bottom line, increase their revenue stream, or reduce their costs. In other words, it means helping them quickly achieve their goals and objectives.”

Value-added auditing needs value-added people to deliver it, and Harrington wants people who are willing to make personal investments to increase their skills. “I think it is important for people to know they own their career,” he says. “We are looking for people who are willing to create a personal mission statement, embrace continuous learning and develop the networks to make the connections that will open the right doors. All of this takes energy, planning and passion. Management and HR can provide tools, but we want people who will own the process and make success a reality for themselves and for the company. I believe in long-term growth and offering professionals a package that allows them to grow individually and professionally. When people succeed, the company succeeds.”

### *Next steps*

Enterprise Risk Management (ERM) has also become a key initiative for Harrington, who is championing the value of ERM across the company. “Studies show that few U.S. companies or auditors truly understand the value of ERM,” he says. “We need auditors who believe in the value of the process and can look across business functions and collaborate with the organization to establish the interdependence of risks and opportunities. This will help all of us focus on the areas that are most important to achieving company goals and objectives. I believe we can capitalize on ERM principles without making these initiatives unnecessarily bureaucratic.”

Raytheon is a dynamic company with high-tech products that are sold to the government and the defense industry – this means managing change is critical to long-term success. The IA team is positioned to help leadership manage change effectively. Reporting directly to the CEO, Harrington participates in monthly operating reviews and strategy sessions, helping to identify what is and what is not working and how the IA function can add value by ensuring alignment of the audit plan. “The CEO’s philosophy is that effective controls in each operation and function minimize surprises,” Harrington says. “To be a strategic partner, IA must understand the business operations and their inherent risk, control and compliance issues. This way, we can ensure that we have a seat at the table.”



## T-MOBILE USA, INC.'S BUSINESS RISK MEASUREMENT FRAMEWORK

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T-Mobile USA, Inc. is one of the fastest growing wireless service providers in the industry, offering digital voice, messaging, and high-speed wireless data services to more than 20 million customers in the United States, with a worldwide network that reaches more than 260 million people. T-Mobile has coverage in 80 countries with more than 180 roaming partners.

Michael Rimkus has been the Director of Internal Audit at T-Mobile for two years. During that time, he and his team have embarked on a comprehensive initiative called the Business Risk Measurement Framework that is designed to help the Internal Audit team and the company's leadership stay abreast of the rapid growth that has come to characterize T-Mobile.

T-Mobile emerged in the United States in 2002 through the acquisition of Voicestream Wireless and is now one of the top four wireless carriers in the industry. Customer service and responsiveness are hallmarks of the company's success. T-Mobile was the first wireless carrier to restore wireless service to the hardest hit areas of New Orleans in the aftermath of Hurricane Katrina.

According to Rimkus, the internal audit (IA) team wanted to design a process to help them keep pace with the company's evolution and that would also enable business leaders to proactively identify risks across business units and be prepared to prioritize resources to address the company's most significant exposures.

### *T-Mobile's organizational structure*

The IA team is organized to match the structure within the company.

"We try to functionally align our IA management team," Rimkus says. "One of my managers on the financial/operational side handles everything in finance, HR and business operations. Another manager oversees sales, marketing and product development. On the IT audit side, our IT senior audit manager is functionally aligned with IT, technical support, WiFi and the wireless network engineering organization." Rimkus currently works with his management team, eight audit staff members, and strategic co-sourcing and outsourcing partners to complete the annual audit plan.

### *Strategic co-sourcing and outsourcing*

In 2003, T-Mobile's IA management decided to try an approach that combined co-sourcing and outsourcing IT audits. "We needed subject matter experts in billing systems, SAP and network operations for these complex audits," Rimkus says. "We decided that the best way to get optimal value for our IT audits was to bring in these subject matter experts from Protiviti, KPMG and Deloitte & Touche."

The IA team sends out its quarterly IT audit schedule for bidding to the three firms two months before each quarter begins, providing the consultants with a high-level scope and objectives, along with estimated hours. The IT senior audit manager asks the firms to provide their subject matter experts' resumes for leading or staffing the jobs. "Sometimes, to achieve cross-functional, integrated training, our financial/operational auditors interested in learning the technical aspect of projects will work as staff on these engagements," Rimkus says. "Sometimes we fully outsource the engagement, and other times it is a combination. Our current IT senior audit manager manages the outsource relationships and helps to drive change in the organization by bringing in the best resources available in the marketplace to help evaluate the business in those areas."

In the financial/operational audit areas, T-Mobile now has three senior auditors and four staff auditors. They are attempting to fill two senior auditor positions. “It’s hard to find experienced people,” Rimkus says. “One of my biggest challenges right now is finding people who can lead engagements and teams, manage projects, and who also possess solid IA-based skills related to operational, compliance and strategic audit work.”

### *Business Risk Measurement Framework*

In 2003, when Rimkus joined T-Mobile, he was impressed with the growing company and its entrepreneurial spirit. As the company expanded, employees were given the directive to figure out how to get things done, such as how to develop a new program, implement a new system and strategically partner with vendors. “People just rolled up their sleeves and got it done,” Rimkus says.

Now he and his team face the challenge of determining whether the various business units across the company have the appropriate organizational control structure, along with the appropriate policies and procedures in place to sustain results going forward. “Our IA planning process is risk-based and we look at the audit universe as a whole,” Rimkus says. “We meet with the senior management of the company to find out about key risk issues, strategic initiatives and internal control problems upon which to build our annual audit plan.”

“When we first started doing audits four or five years ago, management was able to keep pace with all of the issues being raised. However, the company has grown so fast that the organization’s ability to keep pace with the output of the audit function has reached a saturation point. We now need to prioritize our recommendations for them at the enterprise level.”

To meet this need, the T-Mobile IA team designed the Business Risk Measurement Framework (the Framework) and follow-up database, an innovative system for identifying, rating, comparing and tracking outstanding exposures throughout the organization.

The Framework evaluates audit issues across the company, using a risk matrix for plotting key management issues within the company. It provides an accurate visual depiction of the risks’ impact to the business and the likelihood of occurrence. The value the Framework provides T-Mobile’s executives and the IA team is centered on its comparisons within risk groups, or “common risk themes” throughout the organization.

“We needed to understand risks, not on a standalone or audit-by-audit basis, but in comparison to other issues, so that we could determine which risks should be addressed first,” Rimkus says. “The Framework measures the outstanding audit issues we have identified on an impact and likelihood basis, and in comparison with other risks, giving us a complete, integrated, enterprisewide picture of our risk universe. The Framework also allows management to better understand where limited resources should be spent to mitigate the prioritized risks.”

### *Unique reporting structure*

To report the findings of the Framework, the IA team designed a three-level reporting structure. The first level is the Business Risk Measurement Graph, which is sent to each vice president with outstanding audit issues that are being tracked by Internal Audit. The graph contains links, which only the appropriate vice president can access, that lead to four quadrants depicting the impact and likelihood of risks. Points are plotted throughout these quadrants with detailed descriptions of those points listed beside the graph.

The next level is the “Blue Box,” or common themes, report. T-Mobile classifies risks in terms of common themes. For example, issues such as identity management, security management and limited security monitoring might all be grouped under the common theme, “Security.” The graph is classified using these common themes, illustrated with Blue Boxes on the graph. Readers are invited to drill down to get more detail.

*“We needed to understand risks, not on a standalone or audit-by-audit basis, but in comparison to other issues, so that we could determine which risks should be addressed first. The [Business Risk Measurement] Framework measures the outstanding audit issues we have identified on an impact and likelihood basis, and in comparison with other risks, giving us a complete, integrated, enterprisewide picture of our risk universe. The Framework also allows management to better understand where limited resources should be spent to mitigate the prioritized risks.”*

*– Michael Rimkus, Director of Internal Audit, T-Mobile USA, Inc.*

Importantly, each Blue Box contains a rating. The rating is based on 12 factors and is weighted according to percentage, adding up to 100 percent. The factors measuring the impact to business units include:

- Financial (25 percent)
- Accounting Misstatement (15 percent)
- Technology (15 percent)
- Strategic (15 percent)
- Regulatory/legal (15 percent)
- Reputation (15 percent)

To measure likelihood, the factors are:

- Known incidents of the issue (30 percent)
- Pervasiveness of the control gap to the company (20 percent)
- Process maturity (20 percent)
- Recent expansion, growth or change in the affected process (10 percent)
- Complexity of affected transactions (10 percent)
- Volume of affected transactions (10 percent)

“We rate on a scale from one to five,” Rimkus says. “The highest risks would be scored a five and five. The Blue Box will show that score on the quadrant, which will alert the vice president about the severity of the risk.”

The third level is the “Observation Report,” an interactive report that allows readers to drill into the detail of each of the three reports. “This was a major initiative for us,” says Rimkus, who along with his team has been focused on the Framework and follow-up database for the past nine months. “It is our goal to provide our internal business partners with customized reporting, filtering options, drill down options, and the ability to understand, quantify and prioritize risks as they occur, and in some cases before they occur, throughout our organization.”

“I have been in internal auditing for 15 years and I’ve never done anything like this, and I don’t know many companies that have,” he says.

The feedback has been positive; the company’s senior management is able to access, discuss and act on risk information in a timely and effective way. According to Rimkus, “We really have focused on strategically aligning with our internal business partners and helping to simplify the process of addressing critical issues. This helps management focus on where they can best devote resources, from an audit perspective, to address significant risks within the business.”



## INTERNAL AUDITING WITH CRSA AT TELECOM ITALIA GROUP

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The Telecom Italia Group is a leader in the Italian information and communications technology market. The company spans the entire communications services chain, including fixed and mobile telephony, the Internet, media and innovative business solutions and systems through TIM, Telecom Italia Media and Olivetti.

Through its extensive network, Telecom Italia Group helps to drive fixed and mobile broadband services in Italy and in countries throughout Europe, Turkey and Brazil, where TIM is a primary GSM-line service provider. Telecom Italia promotes research and innovation through the laboratories of Telecom Italia Lab, which develop technologies that improve and enhance the services the Telecom Italia Group provides.

Alberto Ragazzini, an internal audit vice president of Telecom Italia Group, is the head of Audit Plans and Models. “Telecom Italia has adopted a one-company organizational model with its core business areas – fixed and mobile services – within the same structure,” says Ragazzini. “Additionally, we have a group of staff and common services departments at the corporate level and two smaller business units that focus on media and office products business areas.”

Ragazzini’s organization, Telecom Italia (TI) Audit, is a separate legal entity within the Telecom Italia Group. Technically, TI Audit is a consortium among the listed companies in the group. That solution is the only one which allows a centralized internal audit in the multilisted group within the Italian regulatory environment. There are 50 audit professionals and 10 support staff in Italy servicing the European regions and 15 in Brazil focusing on Latin American business. Within this audit division, one team oversees audit plan models and another is in charge of special projects, which are primarily related to compliance with Sarbanes-Oxley legislation, as the company is listed in Milan as well as in New York. While some of the company’s auditors focus on general audits and technical audits, such as audits on business processes, technical information systems or network processes, Ragazzini’s team oversees audit plans and models and focuses on methodologies, planning, systems and specific compliance auditing.

“An action plan may originate from audit, risk assessment, compliance programs or the 404 project,” says Ragazzini. “A group compliance officer operates in direct coordination with the IA function. In this respect, this officer’s main responsibility is to monitor the effective realization of all the action plans defined by the Telecom Italia Group management in order to improve the internal control system.”

### *Information technology*

“We have the tools and information for audit activity as well as two application systems that we manage and operate for the group,” says Ragazzini. “For our audit activity, we strive toward a paperless environment, so all of our work papers and reports are managed with a central server. We have adopted a software product for cryptography, which provides an adequate level of logical security with the encryption of all sensitive documents in the central server. We also use ACL for data mining and analysis, which, in conjunction with the extensive integration of SAP in the group, gives us widespread access to accounting and business data for audit tests.”

## *Control and Risk Self-Assessment (CRSA)*

According to Ragazzini, beyond the traditional audit approach for internal controls assessment and development, the IA function has recently played a central role within the Telecom Italia Group regarding the implementation of control self-assessment methodology, called the Control and Risk Self-Assessment process (CRSA).

“This group-wide application system was established in 2003 and is now applied both at the group and operating level throughout the organization, in Italy and worldwide,” he says.

Currently, the IA function has a specific role in assessing the effectiveness and efficiency of this risk management approach. The IA team retains the maintenance of the methodology and the management of the information system that supports the methodology. The execution of the CRSA process itself is a defined responsibility of the management team who is required to identify and assess the risk elements in terms of probability of occurrence and impact on the strategic objectives defined annually by the two CEOs.

“At this point, management assesses the existing control system and determines the acceptability of residual risks and develops plans to adapt controls for unacceptable risks,” Ragazzini says.

*“An action plan may originate from audit, risk assessment, compliance programs or the 404 project. A group compliance officer operates in direct coordination with the IA function.”*

*– Alberto Ragazzini, Vice President of Internal Audit, Telecom Italia Group*

CRSA system management is a significant task, as the system currently supports more than 1,000 users across Telecom Italia Group. Within this system, the group compliance officer promotes the spread of governance, risk management, a controls culture and the existing methodology within Telecom Italia Group. With regard to CRSA, TI Audit works closely with the group compliance officer, as well as operating unit compliance managers who have several key deliverables and goals, including:

- Taking charge of the diffusion of the CRSA approach
- Encouraging the active participation of management
- Collaborating with management during the application of the methodology
- Supporting management in the use of information technology CRSA tools

## *Audit planning*

Ragazzini explains that the audit planning process begins with the identification of key areas of risk that may jeopardize the achievement of the company’s defined strategic objectives.

Those areas are agreed upon annually with the Audit Committee. Additionally, on a quarterly basis, TI Audit proposes an audit review scope for the coming quarter to the Audit Committee. This two-level planning process provides effective coverage for key risks along with great operating flexibility. Input for the annual planning process comes from varied sources, such as:

- The IA team’s own risk assessment
- Requests from management
- Requests from the Board of Auditors and Control Committee

- Requests from IA managers
- Collaboration agreements with external auditors
- Critical situations known to IA

### *Monitoring*

“We believe we have succeeded in turning a traditional source of weakness in the audit process – the monitoring of the implementation of audit recommendations – to a point of strength,” Ragazzini says. TI Audit has built an effective monitoring process based on two key elements:

- The ongoing, proactive collaboration between compliance managers and the line managers responsible for action implementation
- The creation of an information system

This system is called Action Plan Monitoring (APM), and it tracks actions associated with each recommendation in terms of responsibilities and deadline. APM provides a powerful escalation mechanism to the highest level of the group in case of lack of action.

With these two elements in place, the IA function can report to the control bodies on both control deficiencies and degrees of implementation of action plans.

“In 2004, our IA function underwent a quality assurance review by The Institute of Internal Auditors,” says Ragazzini. “We were found to be in compliance with the IIA International Standards for the Professional Practice of Internal Auditing and Code of Ethics. The IIA performed an overall review of our audit organization, policies and procedures, methodology and IT support systems, in order to evaluate its effectiveness in carrying out its mission and its capacity to add value to Telecom Italia Group. We were provided with a set of recommendations in order to enhance IA management and work processes, such as our planning processes, working papers and training policy.”

### *Challenges ahead*

In 2005, the IA team adopted a consulting role within the company’s Sarbanes-Oxley 404 implementation teams. Going forward, the team will take an active role in testing key controls in place throughout the organization.

Beyond Sarbanes-Oxley, Ragazzini sees many challenges and opportunities ahead. “After the implementation of the CRSA in Telecom Italia Group, our role has evolved from a traditional, control-based audit approach to a risk-based audit using the same approach the auditee is familiar with from his experiences with CRSA,” he says. “This means we must achieve a complete turnaround in our methodology in the near future. Results to date have been encouraging; audits are more focused and the audit evaluation of the internal control system is now strictly related to business risks.”

According to Ragazzini, the major challenge his team faces is finding a new role – or, better, repositioning the old role – as CRSA consolidates in the day-to-day managerial practice of the Telecom Italia Group. “This will include a CRSA review; a non-CRSA, external evaluation of behavioral issues, such as fraud; a new approach toward unstructured and quickly evolving situations, such as start-ups; and an even tighter integration with the group compliance officer.

“What is really unknown is the weight each component will have in the future of the TI Audit function.”



## RISK MANAGEMENT AND ASSURANCE AT TELSTRA CORPORATION LIMITED

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Telstra Corporation Limited is Australia's leading telecommunications and information services company, offering a full range of services in telecommunications markets throughout Australia. Telstra provides more than 10 million Australian fixed-line services and approximately 8.6 million mobile services.

The company's international business includes a 76.4 percent interest in CSL New World Mobility Group; Hong Kong's number one mobile operator in terms of revenue, profitability and customers; TelstraClear Ltd., the second largest full-service carrier in New Zealand; and Reach Ltd. (REACH), which is a fifty-fifty joint venture with PCCW and one of the leading wholesale providers of combined voice, data and internet connectivity services in the Asia-Pacific region.

Andrew Dix has been Telstra's director of risk management and assurance for the past two years. Prior to this role, his previous 12 years with Telstra have included roles as the financial controller for many of the company's operating divisions. Prior to joining Telstra, Dix worked in financial and external auditing roles at PriceWaterhouseCoopers. His current role represents his first exposure to internal audit.

"Telstra is the only truly national end-to-end telephony service provider in the country," Dix says. "In addition to providing telephone services, we are also involved in mobiles, data and broadband Internet services, management of customers' information technology and telecommunications environments, pay TV and information advertising, and search services and directories, making us a diverse organization.

"We operate a 'one factory' model, where all of Telstra's network design, construction, operating and maintenance services, as well as all related IT support systems, are located in one group while sales and customer care services are located in the customer-facing parts of the organization," he says. "Our general philosophy is to manage our business by doing it once, doing it right for the customer at the lowest unit cost and in an integrated way. We interface with our customers by segment, with retail divisions divided into the main categories of consumer, small business, corporate, country and wholesale. Within each of those retail operations we are moving toward a much more granular and detailed segmentation of customer type, providing packages and solutions based around the needs of those individual segments. Our 'back-end factory' provides efficient, effective, one-touch service and our retail divisions focus on customer needs, pushing those requirements back into the factory."

### *Risk management and assurance*

The risk management and assurance function at Telstra consists of approximately 50 professionals, a number that includes a small group dedicated to risk management and another group focused on Sarbanes-Oxley compliance. Approximately 40 staff members are dedicated to internal audit.

"We adopt a risk-based internal audit approach," says Dix. "The risk management professionals in our group assist line managers by ensuring they have appropriate risk management frameworks established within their organizations. These efforts are separate from the internal audit focus."

Dix reports to Telstra's CFO and the chair of the audit committee. Six individuals on his department's leadership team, who are responsible for overseeing one or more of the operating

business units, report directly to Dix, and the remainder of the staff report to one of those six managers. “We have a fairly flat structure in terms of reporting,” he says. “We operate a pool approach for allocating work so that staff have the opportunity to work across the depth and breadth of the business.”

Technology plays an important role in the audit work at Telstra, with work paper and resource management tools that enable the auditors to plan, schedule and book staff, as well as organize, analyze and communicate audit findings. “We also have an electronic Web-based tracking tool to track actions as a result of our reviews, which is used by our team and the line managers to measure the progress of those responsible for specific actions,” Dix says.

The audit program is organized to allow time for management-initiated work as well as routine audit work. The goal is to perform not only the audit work designed to meet regulatory or governance requirements, but also to complete the work that line managers most want help with. “By focusing on ‘what keeps line management awake at night’ we are ensuring our effort is focused on the most important areas,” Dix says. “Our philosophy is to meet management requests for information or review wherever possible. This will ensure that management continues to come to us for help and it also assists us in developing a closer working relationship with the business and keeping abreast of emerging issues. It is one of our performance metrics in our balanced scorecard.”

Another important tool is the one designed to support Telstra’s control self assessment (CSA) program, which is used by Dix’s team and by those responsible for controls testing. “We use this tool for recording process documentation and test results,” he says. “While we use this as part of our Sarbanes-Oxley compliance program, CSA was originally conceived as part of a cultural change program inside Telstra to raise line staff awareness of their responsibilities for their own risk and control environment.”

*“We have a fairly flat structure in terms of reporting. We operate a pool approach for allocating work so that staff have the opportunity to work across the depth and breadth of the business.”*

*– Andrew Dix, Director of Risk Management and Assurance, Telstra Corporation Limited*

### *Staffing the function*

Like many audit departments, Telstra’s team is viewed as a training ground and resource pool for the rest of the company, making turnover a constant challenge. “Our group turnover is 25 to 30 percent per year,” says Dix. To manage this challenge, he and his team have developed a strong graduate program to source individuals from universities, even inviting students to intern with the group to attract them to the company and the profession. Only rarely is audit staff sourced internally. “One of the opportunities I want to capture is to try to move people from inside the organization to the risk management and assurance group as part of our development program,” he says. “This effort is embryonic. We want to encourage Telstra employees to join our team as part of a general development program, similar to other companies in which time spent in the audit function is mandated. We are actively seeking professionals whose experience extends beyond finance.” Currently about 50 percent of the auditors are finance trained with the remainder coming from a number of diverse backgrounds.

The risk management and assurance group produces a skills matrix that depicts the type of audit work performed annually compared with skills gaps. “We assess our current employees against this matrix and target our recruiting programs to make sure wherever possible we fill our skills shortages,” he says. Dix also looks for professionals with leadership and project management skills

who can operate effectively in the Telstra environment. “We have developed a strong training program to assist our junior staff members to build their auditing skills, programs that are also useful when we bring people into the group with no audit background,” he says. “Given our role as a training ground, we also look for people who can be successful in other parts of Telstra over time.”

### *Strategic goals and priorities*

The risk management and assurance group is highly customer focused and dedicated to adding tangible value to Telstra, supporting the company’s strategic objectives for success. The group contributes in two important ways:

- Enabling the business to effectively manage key strategic, operational and financial risks by dedicating significant time to training people in the organization and arming them with innovative audit tools and techniques.
- Providing independent assurance that the internal control and risk management environments, including its systems and processes, are operating effectively and efficiently.

Dix has also identified six key priorities for the risk management and assurance group:

1. Embed risk and opportunity management as a tool for business success.
2. Maximize business benefits from the Sarbanes-Oxley initiative, using it to drive benefits throughout the organization.
3. Establish a control culture inside Telstra, making sure employees understand that a strong control environment helps line managers achieve greater success and higher confidence in the way their organization is working.
4. Develop non-audit service offerings to proactively meet customer needs, assisting with controls advisory and “project health checks,” making sure that the appropriate control environments are established during the design and build phases of projects.
5. Conduct risk workshops and risk management tools training to facilitate risk-based thinking throughout Telstra.
6. Conduct emerging risk assessments by working with line management to identify key areas of risk within their strategic objectives and design appropriate plans to manage those risks.

“Our risk-based approach begins with our planning process where, in conjunction with line managers, we develop an overall risk map of the organization,” Dix says. “The focus is on strategic and operational, as well as financial risk. We examine both the likelihood and impact of each risk, then use that insight to focus our attention on the highest risk areas. The fact that this is done with line management also assists in the overall risk management framework as it ensures line managers are also developing those frameworks as part of the annual business planning process.”

The audit plans presented to the audit committee leverage extensive coordination between the risk management and assurance group and the company’s external auditors, ensuring that all appropriate areas are addressed, regardless of who performs the work. The goal is to make sure work is not duplicated, has a minimal impact on business and is performed effectively and efficiently. “Using our risk-based approach, we only audit the areas that we consider to be of significant risk and we only audit them once, unless there is a governance requirement that says otherwise,” Dix says.



## *Governance*

Both the Sarbanes-Oxley requirements and the Principles of Good Corporate Governance and Best Practice Recommendations of the Australian Stock Exchange (ASX guidelines) effectively require the CEO and CFO to certify certain matters with regard to the adequacy of risk management practices and internal controls.

Consistent with Australia's principles-based approach to regulation, generally the best practice recommendations outlined in the ASX guidelines are not prescriptive. Instead, they give a company the flexibility to adopt the best practice recommendations it considers appropriate for its organization. To the extent that a listed company has chosen not to adopt one or more of the best-practice recommendations, it is required to identify and explain those deviations. "Telstra complies with all of the ASX guidelines including those relating to the management of risk and the control environment," Dix says.

In deciding how best to comply with the Sarbanes-Oxley requirements, Dix examined the role the internal auditors would play with regard to their background, training, awareness and auditing skills and techniques that could be applied to this challenge, especially the focus in Section 404 on internal controls over financial reporting. "However, we also decided that as a company we wanted to increase the level of accountability of line managers for their own risk and control environments," Dix says. "Our group was responsible for designing and building the process to ensure Telstra's compliance with the requirements of Section 404, but we only conduct the mapping, process documentation and key control evaluation requirements of the process. Once we have arrived at that point the key controls would be tested by the line management of the business, using the CSA approach. As the controls culture in the business improves we would aim to push more work out into business units."

## *Rising to the challenge*

In recent years, the risk management and assurance group has moved from the back-end compliance operations of the company to the front line. "A good audit group these days can really help the company and the line managers achieve their objectives, and that is the challenge for our group. We want to break the traditional audit mold," Dix says. "For line managers to be successful, they know they must have a much stronger grounding in many disciplines, including financial, operational, risk and audit, so professionals with those backgrounds are the ones we are seeking for our team. These people can provide enormous assistance with meeting the challenges of the audit team, but are also the line managers of tomorrow."

"Attracting the right sort of people is one of our biggest challenges," Dix says. "To ensure that our group is perceived as adding value that goes beyond auditing, we have to be prepared to capture the opportunities as they emerge," he says. "This is a major challenge for our group – to be a pivotal player, a valuable consultant, for the company. If we don't rise to the challenge, someone else will."

# Time Warner

## TIME WARNER INC.'S STRATEGY: A GLOBAL BRAND WITH LOCAL PRESENCE

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Time Warner Inc. is a leading global media and entertainment company with businesses focusing on filmed entertainment, interactive services, television networks, cable systems and publishing. Time Warner has seven distinct business divisions: America Online (AOL), Time Inc., Time Warner Cable, Home Box Office (HBO), New Line Cinema, Turner Broadcasting System and Warner Bros. Entertainment.

In early 2001, Time Warner merged with AOL. At the time of the merger, AOL had an internal audit (IA) function of about 12 internal auditors, in contrast to the Time Warner IA function that had been largely outsourced to its external audit firm. Shortly after the merger, Steve Fiedler was appointed vice president of internal audit. "My first job was to manage this small group of auditors, along with a large contract with an outsource provider," says Fiedler. "In the wake of corporate scandals typified by WorldCom and Enron, new auditor independence regulations made it impossible to use external auditors to perform the internal audit work, so in the first part of 2002, we decided to build a new department." Fiedler, along with Rodney Hawkins, who was hired as an executive director for the company's new IA function in late 2001, helped design an IA team to manage risks and internal controls across the seven divisions.

### *In the beginning*

Time Warner operates as a holding company of seven divisions as opposed to a fully integrated, assimilated group of companies. The size of the divisions is considerable. Many would qualify as Fortune 500 companies, independent of Time Warner. Naturally, each division is led by skilled and strong management teams with unique perspectives on internal controls and how the IA function should operate.

"When we looked at how to set up our IA function, we considered it critical to align ourselves at the director level with the seven divisions, appointing one individual as the primary point of contact with each division," says Fiedler. "Currently, the IA team has four directors to cover the divisions, with other individuals appointed to work across multiple divisions." The IA team uses a strategic co-sourcing approach to cover technologically intensive and international audits, with 55 in-house auditors and 20 full-time employees from a third-party outsource provider.

The IA directors and executive directors operate as the chief audit executives for the divisions they service. "We interact directly with divisional management, conduct risk assessments, develop and execute audit plans, and apply a consistent methodology on an enterprisewide level," says Hawkins.

"We also share the administration and back-office functionality, ensuring that it, too, is standardized. However, while the audit work and methodology is standard, the approach is tailored to the business needs and cultures of the divisions."

## *A global brand*

One of the most significant achievements to date for both Fiedler and his management team is that they have helped Time Warner develop a global audit brand. Historically, because of the unique operations of each division, the audit reports produced for the individual divisions used dissimilar language, format and style of reporting. “We have spent considerable time building a global audit brand for the company,” Fiedler says. “All of the audit reports have a standard language, look and feel, making it easier to integrate audit findings and efforts across the organization.” One method of integration is the group’s Business Risk Model, which assists the audit team in assessing risks across the seven divisions. The IA team has used the Business Risk Model for three years as the basis for annual risk assessment, which classifies business risks on a scale of high, medium or low. More time and resources are allocated to areas deemed high risk in an audit plan that is based on these assessments. “Using one model across all seven divisions helps us prioritize risks between divisions,” says Fiedler.

Not only is Time Warner segmented into seven business divisions, it is also separated geographically: Los Angeles is the home of Warner Bros. Entertainment; Atlanta is the Turner operations’ headquarters; North Virginia is the headquarters of AOL; and the New York metropolitan area comprises Time Inc., HBO Corporate, Time Warner Cable and New Line Cinema. To align as closely as possible with these business units, there are auditors in each location. Internationally, Fiedler uses an outsource provider to service overseas operations in 60 countries.

All of the audit directors report to Fiedler, similar to the way an accounting firm would manage a global account. “I consider each of the directors the ‘engagement partner’ for that division, and I expect them to work closely with the division’s CEO and CFO,” Fiedler says. “I serve as the ‘global managing partner’ and the liaison to the Audit and Finance Committee.”

## *Auditors as a strategic resource*

“When we began interviewing and hiring auditors to build the department, we naturally looked for professionals with a public accounting background,” says Hawkins. “From our perspective, that is a great training ground for helping individuals develop the key qualities of an effective auditor and business person. We also looked for CPAs and other professional designations.”

“Additionally, we knew that we needed auditors who possess excellent communication skills, including being an inquisitive listener. We have been highly selective in hand selecting our 55 professionals,” he says.

Fiedler agrees, “When we were establishing the department, we had to decide if the IA function would be used as a traditional career track for professionals who wanted to be auditors throughout their careers, or a nontraditional rotational management development program. We decided emphatically on the latter. We are looking for bright, articulate professionals with verbal and written communication skills who possess a high management potential.

*“We have spent considerable time building a global audit brand for the company. All of the audit reports have a standard language, look and feel, making it easier to integrate audit findings and efforts across the organization.”*

*– Steve Fiedler, Vice President of Internal Audit, Time Warner Inc.*

“We expect auditors to stay within the IA function for two to three years, and then we devote time and resources to identifying the right management positions for them throughout Time Warner.”

Though the IA team is still young, more than a dozen auditors already have been channeled into operational and finance positions throughout the company, an accomplishment that stems not only from the quality of the auditors themselves, but on the efforts of Fiedler, Hawkins, and the rest of the management team. They have educated the company on viewing the auditors as strategic resources, meeting with the recruiting directors, CFOs and controllers of each division, and incorporating a discussion into each audit at the closing sessions, reminding the audience that the IA group is rotational in nature and consists of ready and eager operational and finance professionals.

The management team also has coached the auditors on how to approach the rotational process, distributing an FAQ on the process that outlines the IA function support role and the steps to take to find the right future position. They are dedicated to helping their team members embark on the next chapter of their careers.

### *The mission*

Time Warner’s audit mission consists of three primary goals:

- Strengthen controls
- Improve performance
- Develop future business leaders of the company

At the onset, the IA team’s short-term goals included very basic items, such as securing office space and connecting phones. “It was like a start up,” Fiedler says. “We were starting a business and taking the first steps toward working with each division.”

Over the past three years, the goals have broadened considerably. The team developed an infrastructure that includes work paper methodology, common audit tools, documentation standards and formal reporting techniques. Capturing information was essential for managing the audit team. “We had little means of knowing how we were doing as a department,” Fiedler says. “We have subsequently built extensive monthly reporting tied to key performance metrics so that we can measure our progress.” These metrics include timeliness of report issuance, the ratio of budget-to-actual, and chargeability and productivity levels for each auditor.

As the IA function evolved, relationships with the business managers of the seven divisions evolved with it. Today, the relationships are solid, but unique to one another. “Early on we went to great lengths to announce ourselves and outline our expectations,” Fiedler says. “We gathered a significant amount of feedback and input before we built the audit function.”

Once the auditors began to roll out their methodology and produce the new, globally branded audit report, they had to continue the education process with the business divisions. “People have come to understand and appreciate what we are all about,” Hawkins says.

Customer satisfaction is measured at the end of each audit engagement, based on a five-point scale. The IA team’s average score is 4.3, an indicator that both the audit work and the relationships the team members have forged with the business divisions are a success. “We have implemented a proactive approach to customer satisfaction,” says Hawkins. “It is time consuming to perform these surveys after each audit, but it is absolutely the right thing to do.”

## *Enterprisewide audits*

In the past year, the IA function has incorporated enterprisewide audits into its audit work. “This is challenging in a global organization like ours,” says Fiedler. “We have found that our reporting at the audit committee level can become somewhat irrelevant when it is focused on a specific audit issue at a specific division. With enterprisewide audits, we look for risk commonality across our divisions and select topics of high interest and relevance.”

Hawkins adds, “Enterprisewide audits enable us to execute the audit process in a way that addresses risk across all of our divisions. We hold round table discussions with all the audit teams to identify strengths and weaknesses across the company so that we can present meaningful, comprehensive results to the audit committee.”

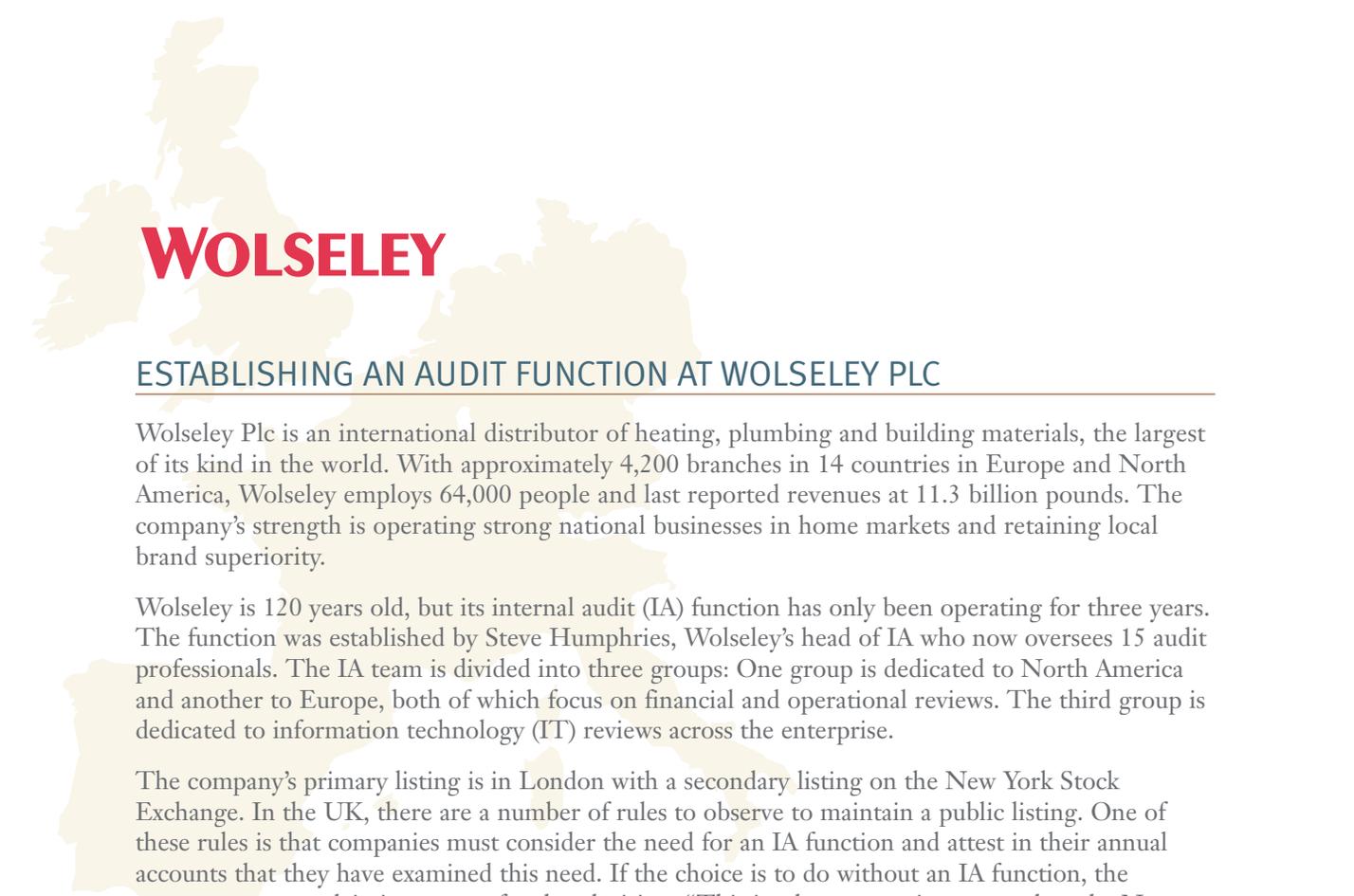
## *Challenges ahead*

According to Hawkins, the IA team faces two primary challenges. The first is continuing to attract world-class auditors to the company. “The fact that we have a rotational program means that about 40 percent of our people rotate out of our group every year,” he says. “We are in constant recruiting mode and that can be difficult. Getting quality people in the door is an exceptional challenge.”

The second challenge is to continually raise the bar on IA performance. “As our group matures, we must continue to add value to the organization, understand the business risks within the divisions and identify relevant issues to be addressed,” Hawkins says.

Fiedler points out another challenge, one related to Sarbanes-Oxley. “Sarbanes has had a dramatic impact on IA functions,” he says. “One of the challenges that we and many other IA teams face is carving out a role for ourselves when management is spending a significant amount of time focusing on one risk – Sarbanes compliance risk – in the risk universe.

“As an IA function, we have not traditionally focused on external financial reporting, as there are so many risks critical to the success of the company,” he says. “For many companies, Sarbanes has diverted management’s and IA’s attention away from those other risks. One of our challenges is to be vigilant in helping management understand that Sarbanes is just one in a portfolio of risks that require assurance.”



# WOLSELEY

## ESTABLISHING AN AUDIT FUNCTION AT WOLSELEY PLC

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Wolseley Plc is an international distributor of heating, plumbing and building materials, the largest of its kind in the world. With approximately 4,200 branches in 14 countries in Europe and North America, Wolseley employs 64,000 people and last reported revenues at 11.3 billion pounds. The company's strength is operating strong national businesses in home markets and retaining local brand superiority.

Wolseley is 120 years old, but its internal audit (IA) function has only been operating for three years. The function was established by Steve Humphries, Wolseley's head of IA who now oversees 15 audit professionals. The IA team is divided into three groups: One group is dedicated to North America and another to Europe, both of which focus on financial and operational reviews. The third group is dedicated to information technology (IT) reviews across the enterprise.

The company's primary listing is in London with a secondary listing on the New York Stock Exchange. In the UK, there are a number of rules to observe to maintain a public listing. One of these rules is that companies must consider the need for an IA function and attest in their annual accounts that they have examined this need. If the choice is to do without an IA function, the company must explain its reasons for that decision. "This is a less aggressive stance than the New York Stock Exchange takes, but nevertheless the requirement is there to examine the need for an IA function," says Humphries. "It is unusual for major UK companies not to have IA functions, so for a period of time Wolseley stood apart from competitors and peers in this regard. It was eventually decided to establish such a function because our corporate office wanted a better sense of how the various geographically dispersed components of the business were applying group policy. One way to achieve this was to establish an IA function. So I came on board."

### *Communicating expectations*

Humphries' professional experience includes helping to evaluate and improve IA performance in other companies. "At the time I joined Wolseley, I was used to collaborating with audit clients, hearing their concerns and explaining what we're doing and why," he says. "My aim is to ensure an audit function is designed to deliver value."

Upon joining Wolseley, he wanted to ascertain that the company was not simply establishing a nameplate function to satisfy the listing rules. "I spent time talking to people at the corporate office to make sure they were really buying into the value that audit can deliver," he says. "I also met with senior-level professionals in the business, explaining to them the mission and vision of the IA function as well as the types of services and solutions we would deliver."

For Humphries, who reports to the CFO and the audit committee, some of the most important aspects of an IA initiative involve effective communication between senior management, the IA team and audit clients. Part of this communication includes explaining to business unit managers the importance of addressing risks, exposures and problems with internal controls in a collaborative and proactive way. "I wanted to ensure that these individuals understood that we would work together to resolve any outstanding business issues," he says. "Incorporating internal audit across the enterprise was an important cultural change for Wolseley, and it was critical to build good working relationships from the start, engendering trust as much as possible. I view the audit client as an integral part of the process since they are the ones who truly understand where the risks and issues are in the business."

After conducting the initial series of discussions, Humphries recognized that, since building an audit staff takes time, it was time to outsource the initial audit work to an outside provider to demonstrate the ability to add value immediately. The IA provider worked according to Humphries' audit standards and methodologies, conducting the first round of audit reviews and producing reports. "This gave me time to build an internal team," he says. "Six months later, when a small team was in place, we transferred the work internally. To the audit client this was a seamless transition, as our provider was working according to our plan and approach."

*"Incorporating internal audit across the enterprise was an important cultural change for Wolseley, and it was critical to build good working relationships from the start, engendering trust as much as possible. I view the audit client as an integral part of the process since they are the ones who truly understand where the risks and issues are in the business."*

*– Steve Humphries, Head of Internal Audit, Wolseley Plc*

The cultural shift of incorporating an IA team in the company led Humphries to expect a certain amount of resistance. "I was pleasantly surprised by the warm reception we have received," he says. "The businesses are proud of the work they do and view audit as an opportunity to report on their success to the head office. Even if an audit review is not as positive as we would like, the audit client reaction has been excellent. They are very positive and want to do the best they can. If change is required they implement it quickly and effectively."

### *Staffing the team*

The first skill sets Humphries focused on when developing his team were financial and IT audit competencies. "Financial audit is essential for an IA function, and that is something you build on, but should never lose sight of," he says. Outside of core finance expertise, he sought out professionals with excellent communications skills, good judgment and a high level of personal integrity. "We are communicating and selling ideas to people all the time," he says. "As an auditor you must be an effective salesperson, as well as a technically adept audit expert."

Humphries sources auditors both internally, from a variety of different business areas to gain operational knowledge for his audit team, and externally, to infuse the function with fresh ideas. The recruitment process was structured and involved a series of interviews, case study audit tests and a personality evaluation. "Our recruitment process demonstrated our level of professionalism as a function," he says. "Our process has been successful; we have had virtually no staff turnover."

Since the audit function is only three years old, only one auditor has transferred out to take on a managerial role elsewhere in Wolseley. This is part of Humphries' vision for the future – the IA function as a training and development ground for the company. "I will work hard to provide auditors with an opportunity to develop their careers outside of the function," he says. "I expect them to spend two to three years here and then move into a role within the business. However, I am not interested in refreshing the entire the team every three years, so I want to keep a core team within the department for approximately five to six years, those who can share knowledge with new auditors and provide continuity for the function and the audit clients as well."

"IA is often seen as a significant step in overall career development because it provides a unique opportunity to learn so much about risk management," he adds. "Once you start talking about risk, people understand how the IA function ties into their own strategic objectives."

The short-term goal was to get the function up and running and begin producing audit reviews and reports. As the team progresses in its third year, Humphries plans to establish a more structured link between audit work and the company's existing governance framework, including a focus on financial, operational, strategic and compliance risks. "We will reconcile our audit approach to the company's strategic drivers. For example, one driver for Wolseley is to attract and retain high-quality, talented employees. Therefore, HR management is a key aspect of our audit plan for next year. We are exploring how the company manages existing staff, including performance reviews and career development, as well as how efficiently and effectively we recruit new hires."

### *Measuring performance*

As with any new function, performance measurement is essential to gauge progress and make any necessary adjustments. Humphries has built performance measurement into the audit process by providing all auditors with formal reviews after each significant audit assignment is complete. A formal annual appraisal process and a less formal semi-annual appraisal process also take place so that everyone is clear about objectives. Additionally, after each audit review Humphries sends out a survey to the audit client to gather feedback on IA team performance, the perceived relevance of the work and the audit process itself. Finally, an annual IA effectiveness survey of 80 questions is sent to the audit committee, external auditors and the board of directors. "The goal is to ensure that we are adding value at every level," he says. "Next year I will have a third party review the IA team for quality assurance."

### *Reviewing corporate governance*

For Wolseley, 2006 is the first year for Sarbanes-Oxley compliance. "We are working hard at the moment to make sure everything is in place," says Humphries, who believes that the correct position for IA within Sarbanes-Oxley compliance efforts is as a quality assurance partner. "I have talked to other IA directors to understand how they position their function within this compliance effort. I found a broad spectrum, from managing the project outright, to conducting documentation and testing, to the other extreme, which is playing no part whatsoever, passing it to the financial control function. We have positioned the IA function at the quality assurance level, so we do not set the rules in terms of how the group approaches the project, but we share our audit methodologies in terms of how to think about control and risk. In this way, we have had significant input at early stages of the initiative."

### *Building the team for the future*

The challenges Humphries sees ahead include the continuing need to educate the business about what role IA can play beyond financial assurance, as well as defining the right size of this function for Wolseley.

Additionally, he wants to continue to ensure that Wolseley employees and managers come to the IA team for support on specific issues. "That happens regularly now and it is a measure of the value they perceive we add," he says. "If there is an issue out there that IA can help support, I feel confident the business units will come to us. We help management look at risks, not in isolation, but comprehensively, across the company.

"We all have one goal in mind and that is for Wolseley to be as successful as it can be. We all have our own role to play in that. It is my intention to continue to explain the IA team's role in the company's long-term success."

## 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 North America, Latin America, Europe, Asia and Australia, is a wholly owned subsidiary of Robert Half International Inc. (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
- Start-up and development advice

### *Other relevant publications and resources from Protiviti*

- *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)*
- Protiviti Risk Barometer
- Supply-chain white paper series from Protiviti and APICS
- KnowledgeLeader ([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 is a subscription-based website launched in 1998 to help internal audit professionals find tools and best practices that improve the quality and efficiency of their work.

Since that time, KnowledgeLeader has been publishing interviews with chief audit executives on a regular basis. Within these “Performer Profiles,” audit leaders from a variety of companies and industries share their tips and techniques for managing risk and improving business processes. They discuss the challenges they have successfully faced in managing their function within the organization, and provide insights and “lessons learned” for their peers. There is now a library of over 100 audit director profiles on the KnowledgeLeader site.

Other tools and resources available on KnowledgeLeader include:

- **Audit Programs** – A wide variety of sample internal auditing work programs and IT functional audit work programs are available on KnowledgeLeader.
- **Policies & Procedures** – You may use the sample finance, business process, technology and human resources policies provided by KnowledgeLeader to help you review, create or update your company policies and procedures.
- **Checklists, Guides, Samples & Other Tools** – There are over 400 tools available on KnowledgeLeader. They include questionnaires, samples, checklists, guides, best practices, templates, and other tools for managing risk, conducting internal audits and leading an internal audit department.
- **Articles & Publications** – Informative articles, survey reports, newsletters and booklets produced by Protiviti and a number of third-party resources, about business and technology risks, internal auditing and finance.
- **Topical Navigation** – The Topic area of KnowledgeLeader provides access to the articles and tools, grouped into special “themed” areas for easy access. The primary topics covered by KnowledgeLeader are:
  - Business Continuity Management
  - Business Ethics and Fraud
  - COSO
  - Enterprise Risk Management
  - Internal Audit
  - Sarbanes-Oxley
  - Self-Assessment
  - Security
  - Technology

Other resources found on KnowledgeLeader include methodologies and models, white papers, conferences and events, online CPE courses, certification information, audit and accounting standards and organizations, and best business links.

To learn more about KnowledgeLeader, sign up for a complimentary 30-day trial by visiting **[www.knowledgeloader.com](http://www.knowledgeloader.com)**. Members of The Institute of Internal Auditors are eligible for a subscription discount.



### *North America*

UNITED STATES  
+1.888.556.7420  
protiviti.com

CANADA  
+1.416.350.2181  
protiviti.ca

### *Latin America*

MEXICO  
+52.9171.1501  
protiviti.com.mx

### *Europe*

FRANCE  
+33.1.42.96.22.77  
protiviti.fr

GERMANY  
+49.69.963768.100  
protiviti.de

ITALY  
+39.02.655.06.301  
protiviti.it

THE NETHERLANDS  
+31.20.346.04.00  
protiviti.nl

UNITED KINGDOM  
+44.207.930.8808  
protiviti.co.uk

### *Asia-Pacific*

AUSTRALIA  
+61.3.9948.1200  
protiviti.com.au

CHINA  
+86.21.63915031  
protiviti.cn

JAPAN  
+81.3.5219.6600  
protiviti.jp

SINGAPORE  
+65.6220.6066  
protiviti.com.sg

SOUTH KOREA  
+82.2.2198.2065  
protiviti.co.kr

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.

*Protiviti is not licensed or registered as a public accounting firm and does not issue opinions on financial statements or offer attestation services.*