
Louisiana Housing Finance Agency



Internal Audit

Collette Mathis, Audit Director

February 8, 2008

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M E M O R A N D U M

To: Commissioner Merriell F. Lawson - Chairman
Commissioner Robert Austin
Commissioner Carolyn Burris
Commissioner Allison Jones
Commissioner John N. Kennedy

From: Collette Mathis, Audit Director

Date: February 8, 2008

Re: Audit Committee

There will be an Audit Committee meeting, Wednesday, February 13, 2008 at 11:00 a.m., at Louisiana Housing Finance Agency, Committee Room 2, located at 2415 Quail Drive, Baton Rouge, LA.

Collette Mathis will provide an update on audit activities and present the 2008 Audit Plan.

If you have any questions or concerns, please contact us.

February 8, 2008

Audit Committee

A regular meeting of the Audit Committee, to be held on Wednesday, February 13, 2008 at 11:00 a.m., Louisiana Housing Finance Agency, Committee Room 2, located at 2415 Quail Drive, Baton Rouge, LA, by the order of the Chairman.

Preliminary Agenda

1. Call to order, roll call and introduction of guests
2. Approval of the minutes of October 10, 2007 Committee Meeting
3. Update on Audit Activities
4. 2008 Annual Audit Plan Presentation
5. Other Business
6. Adjournment

Milton J. Bailey, President

Pursuant to the provisions of LSA-R.S. 42:6.1, upon two-thirds vote of the members present, the Board of Commissioners of the Louisiana Housing Finance Agency may choose to enter Executive Session, and by this notice, the Agency reserves its right to go into executive session as provided by law.

**Louisiana Finance Agency
Audit Committee Meeting Minutes
Wednesday, October 10, 2007
2415 Quail Drive
Committee Room 1
Baton Rouge, LA 70808
10:30AM**

Commissioners Present

Merriell Lawson, Chairperson
Wayne Woods
Greg Gachassin

Commissioners Absent

Robert Austin
Carolyn Burris
Allison Jones
John Kennedy

Staff Present

Collette Mathis
Konchetta Bringier
Dione Milton
Kip Anderson
Rene Landry

Others Present

Candy Wright, Postlethwaite & Netterville
Amanda Perry, Postlethwaite & Netterville
Bill Stamm, Duplantier, Hrapmann, Hogan and Maher
Heather McCardle, Duplantier, Hrapmann, Hogan and Maher

1. Call to order, roll call and introduction of guests.

Chairman Lawson called the meeting to order at 10:00AM and asked for roll call.

2. Presentation of the External Audit Results for Fiscal Year Ended June 30, 2007.

Rene Landry introduces the auditors from Postlethwaite & Netterville (P& N) and Duplantier, Hrapmann, Hogan and Maher (DHHM). P& N is engaged by the Board to audit the Bond Programs and DHHM is hired by the Legislative Auditors to audit the general fund. Rene Landry also informed the committee that there were no audit findings and the financial results were good for FYE June 30, 2007. He also explained the requirements of the firms to meet with the Audit Committee to discuss the reports; this provides independence and direct reporting. Chairman Woods asked Commissioner Gachassin to sit in on the meeting for absence committee members. A quorum was established.

Candy Wright with P&N and Bill Stamm with DHHM provided a joint presentation of the June 30, 2007 financial reports.

At the conclusion of the presentation, Commissioner Lawson asked if there is anything the board can do to be supportive of the Accounting and Internal Audit Departments. Candy Wright's response noted the importance of meeting with Internal Audit on a quarterly basis, having Internal Audit present their findings and reports to the Audit Committee and allowing the Audit Committee approve annual audit plans. From an external perspective, she notes the Board should be included on the annual audit entrance conference held before the audit begins. This entrance conference discusses the scope of the audit. During that time, the board can communicate if there are any issues that need to be addressed or if there is anything that the auditors should do differently.

3. Approval of the minutes. A motion was made by Board Chairman Wayne Woods, and seconded by Commissioner Gachassin to approve the minutes of the October 11, 2006 Audit Committee meeting. The minutes were approved.

4. Other Business. There was no further business to come before the Committee.

5. Adjournment. The meeting adjourned at 10:28 AM.

LOUISIANA HOUSING FINANCE AGENCY

Audit Plan 2008

*Experience
Results
Value*



The mission of the Louisiana Housing Finance Agency is to ensure that every Louisiana resident is granted an opportunity to obtain safe, affordable housing.

**LOUISIANA HOUSING
FINANCE AGENCY**

2415 Quail Drive
Baton Rouge, LA 70808

Phone: 225-763-8700

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LOUISIANA HOUSING FINANCE AGENCY

2415 Quail Drive, Baton Rouge, Louisiana 70808 (225) 763-8700

MEMORANDUM

To: Audit Committee Members
Board of Commissioners
Senior Management, LHFA

Subject: Audit Plan 2008

I am pleased to present our 2008 Audit Plan. The development of the plan was shaped using a systematic approach to help us decide what audits need to be done. This planning process helps us to develop the theme for our audits and identify an appropriate mix of various types of audits. The audit plan helps us to determine how we can best allocate our resources and capitalize on our individual strengths.

Effective audit planning is crucial to the success of the Internal Audit Division at LHFA. Our planning process involved understanding our responsibility, recapping where we have been, and identifying the auditable universe and the risks associated with various programs and activities. The audit plan incorporates input from Senior Management and is presented to the members of the Board, the Audit Committee and Senior Management.

While the scope and assignment of audits is left to the discretion of the Chief Audit Executive, the Agency Head, at any time, may direct the CAE to perform an audit of a program function or organizational unit. Therefore, our work plan sets aside a block of time for special requests and investigations.

Detailed information regarding goals and objectives is available in the enclosed 2008 LHFA Audit Plan.

Collette Mathis, CGAP

Collette Mathis, CGAP
LHFA Internal Audit



MISSION, GOALS, AND ACCOMPLISHMENTS

Mission

The Division of Internal Audit serves LHFA management in the effective discharge of their duties by examining and evaluating operations and activities to provide independent risk assessments, analyses, appraisals, recommendations, counsel, information and assistance. We conduct our activities in accordance with the guidelines outlined in the Standards for the Professional Practice of Internal Auditing. We are obligated to maintain high standards of competence, objectivity and integrity in the performance of our duties and responsibilities.

Accomplishments 2006-2007

- Finalized and issued the Single Family Homeownership Audit Report to management and the audit committee
- Completed the planning and test-work phases of the compliance monitoring procedures audit for the LHFA HOME Department
- Completed the planning and test-work phases of the compliance monitoring procedures audit for the LHFA LIHTC Department
- Completed the planning and test-work phases of the compliance monitoring procedures audit for the LHFA Compliance Department
- Performed follow-up work for the Single Family Homeownership audit and subsequently closed the audit as follow up information was deemed sufficient.
- Completed a full data integration of the LHFA Single Audit Database
- Continued to forward all audits obtained on behalf of the HOME program to Darensbourg, CPA as directed to assist in the development of a financial model to be used to analyze HOME loan repayments
- Consolidated each LHFA departmental policy and procedure manual into one usable file
- Created the LHFA Continuity of Operations plan in conjunction with a team of LHFA employees
- Assisted in the site selection of the LHFA alternate site
- Participated in the training of LHFA employees in disaster recovery procedures
- Prepared and issued the 2008 audit plan update
- Audit Director served as the 2007-2008 President of the Baton Rouge Chapter of the Institute of Internal Auditors
- Assisted in the subcontract/transition of Energy Assistance duties to the Louisiana Association of Community Action Partnerships, Inc.

- Assisted the Energy Assistance staff in reviewing the expenditure documentation of Natchitoches Parish Policy jury and made recommendations for monetary recoupment of funds
- Staff development and training
 - Attendance at monthly meetings of the Baton Rouge Chapter of the Institute of Internal Auditors
 - Attendance at the semi-annual training seminars hosted by the Baton Rouge Chapter of the Institute of Internal Auditors
 - Certified Internal Auditor Prep Course
 - Attendance at the annual Governmental Seminar hosted by Postlethwaite and Netterville, CPA
- Improved cash handling procedures through recommendations made throughout the course of the Single Family Homeownership audit
- Continued to improve efficiency through the use of automated tools
- Participated in management committee meetings and offered recommendations as appropriate
- Explored the use of automated audit software by participating in web demonstrations by various software vendors

Goals 2008

Our comprehensive audit plan is formulated by analyzing the components of each unit or department across the organization and assigning a level of risk to each component. This is done annually by performing an enterprise risk assessment. What is risk assessment? Risk assessment is the identification and analysis of relevant risks to the achievement of an organization's objective. It involves an initial determination of operating activities, then a systematic identification of those things that could prevent each objective from being attained.

Audit priorities are based on those areas of highest risk and those areas where audit assistance is requested. We evaluate our strategies and establish our goals by reviewing the contact we have with our auditees. We also review our internal processes. Are we continuing to explore new techniques and methods to review the mass of data that we audit? Are we staying aware of new developments? Have there been major findings from the Louisiana Legislative Auditor's Office or other outside audits?

As the Internal Audit staff becomes more experienced and familiar with the operations of the Louisiana Housing Finance Agency, our focus becomes fine tuned with the needs of this organization. With experience, advanced procedures are designed and utilized thereby, increasing our effectiveness.

With the above in mind, we have determined the following to be the goals of this Division for the 2008 fiscal year:

- Perform an audit/limited review of the Contract Administration Department
- Perform an audit/limited review of the Special Programs Department
- Solicit proposals from IT consultants to perform a review of the IT function and controls of the LHFA Information Technology Department

- Develop and update audit programs of auditable areas.
- Maintain a comprehensive audit plan to cover areas of risk and allow for contingencies and to work within recognized professional auditing standards and best practices.
- Initiate and conduct operational and compliance audits of selected LHFA programs. This includes the review of operations or programs to ascertain that results are consistent organizational objectives.
- Provide an active contribution to LHFA training programs and management discussion groups in support of raising the level of awareness of staff responsibility for compliance.
- Provide timely reports, information and advice in order to assist our customers with the achievement of their goals and the discharge of their duties.
- Explore the use of audit software available through a variety of audit industry vendors.
- Develop effective relationships with the Board of Commissioners while enhancing Board communication.
- Development of an Informational Tool / Web Link on LHFA's Intranet.
- Educate LHFA employees and managers on internal controls, fraud prevention and audit submission by developing a managers training presentation.
- Improve efficiency through the use of automated tools.
- Adjust staffing levels to respond to service demands and responsibilities.
- Maintain a continuous program of professional development which includes but is not limited to the following:
 - Supervisory and leadership skills
 - Use of statistical sampling
 - Increase knowledge of LHFA operations and federal/state regulations
 - Understanding risk management
 - Analytical and problem solving skills
 - Interpersonal Skills
 - Obtain Staff Certifications
 - Circulate for discussion all relevant articles and materials on finance, risk management, internal controls and to inform management on specific audit projects
 - Staff appraisals
 - Attendance at Human Resource sponsored training programs
- Continue to encourage all professional staff to maintain professional memberships and certifications.
- Continue to coordinate with third party HOME audit reviewer in the development of a financial model to be used to collect on HOME loans.
- Review and update audit charter as needed.
- Keep Senior Management, the Audit Committee, and the Board of Commissioners informed of all pertinent audit matters.



SUMMARY OF THE ENTERPRISE RISK ASSESSMENT

Based on the results of the questionnaire sent to each manager of a major program, the following recommendations are made by the LHFA Internal Audit Division. There were not any new risk factors identified by program management therefore, there were no changes made to last year's risk assessment models.

Program Areas - (2008)

We anticipate performing 2 programmatic internal audits during the 2008 calendar year. Below you will find Internal Audit's thoughts on the program areas to be selected.

Special Programs – A risk assessment will be performed at the engagement level to determine what areas of this department present the most significant amounts of risk. An audit program will be developed and test-work will be performed based on this assessment.

Contract Administration – This program has undergone a tremendous amount of change over the past 2-3 years. It did not receive a high risk rating on the risk assessment model however, in light of the numerous changes in the department's management, the eight fold increase in the amount of available credits to be awarded, and the urgency to provide/restore available housing to those displaced by hurricanes Katrina and Rita, the Internal Audit Department will perform a limited review of this department.

Program	2005-2006	2006-2007	2008
Single Family	X		
Tax Credits		X	
HOME		X	
Compliance		X	
Energy Assistance *		X	
Contract Admin			X
Special Programs			X

* The Internal Audit Division participated in the transition of the Energy Assistance program to the **Louisiana Community Action Providers**. In addition, the Internal Audit Division participated in an expenditure review of the Natchitoches Parish Policy Jury during the 2006-2007 year.

Summary of the Enterprise Risk Assessment

Support Areas - (2008)

We anticipate performing 1-2 support audits/reviews throughout each of the three years of the audit rotation. The scope of these audits/reviews will be determined during the planning phase of each assignment.

We also anticipate the outsourcing of an audit of our Information Technology Department. There is currently no one on the Internal Auditing staff with the level of expertise needed to complete such a review.

Support	2005-2006	2006-2007	2008
Accounting	X (SF)	X (TC, CO, EAD)	
Information Tech	X (SF)	X (TC, CO, EAD)	X
Procurement			
Human Resources			X



STAFFING

Currently, the Internal Audit Division is comprised of three full-time audit professionals. The department has two remaining staff auditor positions vacant. It is the intent of management to fill at least one of the two remaining position by year end. Below you will find the 2008 internal auditing staffing projection.

2008 Staffing Projection

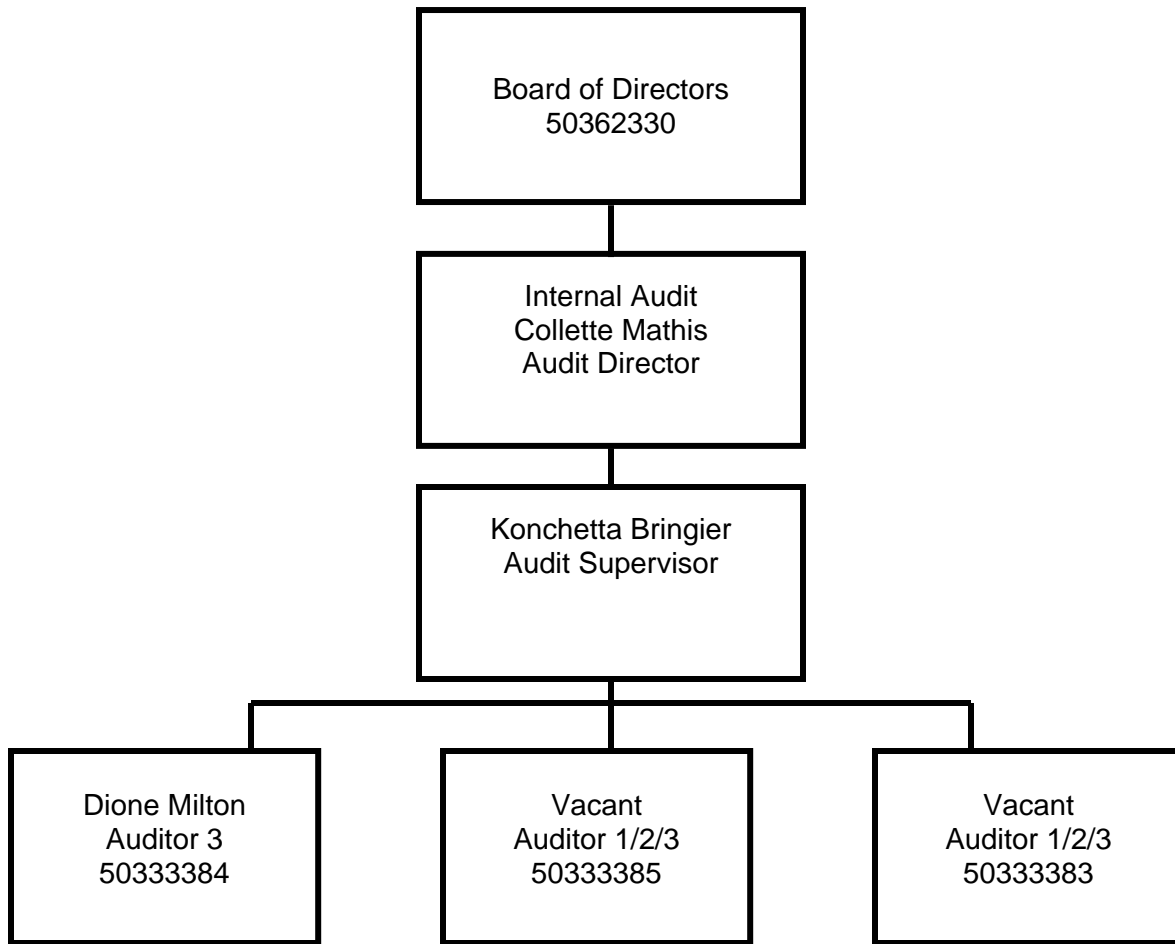
<u>Audits</u>	<u>3FTE's</u>
High Risk/Schedule Audits	2,480
Special Projects	2,494
Risk Assessment	
Audit Plan Updates	
Disaster Recovery and Planning	
HOME Financial Model	
Fraud Reviews	
Circular A133 Tracking and Review	

Subtotal	4,974
<u>Administrative</u>	
Continuing Education	306
Leave	560
Holiday Leave	
Annual Leave	
Sick Leave	
Other	400
Interviews	
Performance Appraisals, Planning	
Administrative Matters	
Safety Training	
Management Committee	
Disaster Recovery	

Subtotal	1,266
Total Projected Hours	6240



INTERNAL AUDIT ORGANIZATIONAL CHART



Job Title	AS Level	Yearly Minimum	Yearly Maximum
Audit Director	AS 622	\$50,898	\$107,078
Audit Supervisor	AS 618	\$38,813	\$81,682
Auditor 3	AS 616	\$33,904	\$71,344

AUDIT DIRECTOR 1

FUNCTION OF WORK:

To direct an audit division of auditors to ensure the proper accountability of public funds.

NOTE:

Audit program must be required by statute, agency Board of Trustees, or federal funding regulations.

LEVEL OF WORK:

Administrator

SUPERVISION RECEIVED:

Administrative direction from a higher level executive.

SUPERVISION EXERCISED:

Direct line over professional auditing staff.

LOCATION OF WORK:

May be used by any state agency with an audit division.

JOB DISTINCTIONS:

Differs from Audit Manager by serving as director of an audit program of medium complexity and scope.

Differs from Audit Director 2 by the scope and complexity of programs managed, size and composition of subordinate staff, and size of audit division served.

NOTE: Additional information concerning this title can be found in the allocation criteria memo.

EXAMPLES OF WORK:

EXAMPLES LISTED BELOW INCLUDE BRIEF SAMPLES OF COMMON DUTIES ASSOCIATED WITH THIS JOB TITLE. PLEASE NOTE THAT NOT ALL TASKS ARE INCLUDED.

Develops and enforces audit standards, policies, and procedures for agency.

Serves as chief auditor of agency.

Interprets laws, rules, and regulations which will impact audit programs at agency and ensure agency compliance with all mandated changes.

Advises department administrators or governing boards of audit findings that will impact agency funding activities.

Recommends suspension or prosecution of entities that fail to comply with agency financial reporting standards.

Meets with audit division staff members and representatives of agency program involved and the audited entity to informally discuss problems with audits and to attempt to resolve discrepancies which otherwise would lead to punitive action being taken up to and including disbarment from the program or to prosecution.

Assists in action taken against an audited entity that fails to comply with agency requirements.

Participates in any forums, steering committees, professional conferences, or training sessions as the chief auditor of agency.

Advises higher-level agency administrators or the Board of Trustees of management problems uncovered by operational audits within the program and makes recommendations for solutions.

MINIMUM QUALIFICATIONS:

A baccalaureate degree with twenty-four semester hours in accounting plus five years of professional level experience in auditing, two years of which must have been at the supervisory level or above.

SUBSTITUTIONS:

A certified public accountant (CPA) certificate or Certified Internal Auditor (CIA) designation will substitute for the baccalaureate degree with twenty-four semester hours in accounting plus one year of the required general experience.

A master's degree with a major in accounting, business administration, finance, management, economics, quantitative methods, or public administration will substitute for one year of the required general experience.

NOTE:

Transcripts verifying any college semester hours in accounting necessary to qualify must be submitted with the application. Qualifying semester hours in accounting must be progressive course work. Credit will not be allowed for two accounting courses which cover essentially the same material.

NOTE:

Any college hours or degree must be from a school accredited by one of the following regional accrediting bodies: the Middle States Association of Colleges and Secondary Schools; the New England Association of Schools and Colleges, Incorporated; the North Central Association of Colleges and Secondary Schools; the Northwest Association of Secondary and Higher Schools; the Southern Association of Colleges and Secondary Schools; the Western Association of Schools and Colleges.

AUDITOR SUPERVISOR

FUNCTION OF WORK:

To supervise a unit of at least three auditor positions in all aspects of an agency audit program.

NOTE:

For any application other than supervisor of internal audit unit, audit program must be required by statute, agency Board of Trustees or federal funding regulations.

LEVEL OF WORK:

Supervisor.

SUPERVISION RECEIVED:

General from an Audit Director or higher level staff professional.

SUPERVISION EXERCISED:

Direct line supervision over a minimum of three incumbered Auditor positions and other professional or paraprofessional unit staff members.

LOCATION OF WORK:

May be used by any state agency.

JOB DISTINCTIONS:

Differs from Auditor 3 by presence of direct line supervisory duties over a unit which includes at least three subordinate incumbered Auditor positions.

Differs from Audit Manager by absence of second line supervisory duties over agency audit division.

EXAMPLES OF WORK:

Supervises all aspects of an agency audit program, including assigning work to subordinate auditors; reviewing, approving, and directing revision of individual audit plans and reports; and providing guidance and counsel regarding audit plan development and audits conducted.

Exercises authority to require modification or additional research by subordinate auditors; approves audits on behalf of agency.

May conduct more sensitive audits or handle matters of great confidentiality related to the audit program.

Prepares or assists in the preparation of the agency annual audit program with input from subordinate staff.

Evaluates performance of subordinate staff members.

Approves usage of leaves of absence by subordinates.

Serves as chief auditor of agency.

Provides technical assistance to audited entity and other parties regarding the audit program.

Represents agency in adjudicatory hearings or in any other forum regarding audit findings.

Responds to inquiries from superiors in audit division or senior agency administrators regarding audits conducted.

Interacts with superiors in audit department regarding performance of auditor subordinates and administrative planning for entire department.

Performs special projects as assigned by chief auditor for agency.

MINIMUM QUALIFICATIONS:

A baccalaureate degree with twenty-four semester hours in accounting plus three years of professional level experience in auditing.

SUBSTITUTIONS:

A certified public accountant (CPA) certificate or Certified Internal Auditor (CIA) designation will substitute for the baccalaureate degree with twenty-four semester hours in accounting plus one year of the required experience.

A master's degree with a major in accounting, business administration, finance, management, economics, quantitative methods, or public administration will substitute for one year of the required experience.

NOTE:

Transcripts verifying any college semester hours in accounting necessary to qualify must be submitted with the application. Qualifying semester hours in accounting must be progressive course work. Credit will not be allowed for two accounting courses which cover essentially the same material.

NOTE:

Any college hours or degree must be from a school accredited by one of the following regional accrediting bodies: the Middle States Association of Colleges and Secondary Schools; the New England Association of Schools and Colleges, Incorporated; the North Central Association of Colleges and Secondary Schools; the Northwest Association of Secondary and Higher Schools; the Southern Association of Colleges and Secondary Schools; the Western Association of Schools and Colleges.

AUDITOR 1

FUNCTION OF WORK:

To conduct financial, compliance, or internal audits for an agency to ensure compliance with agency, state, or federal regulations.

To review and evaluate the effectiveness of procedures.

To measure compliance with agency directives.

NOTE:

For any application other than internal auditor, the audit program must be required by statute, agency Board of Trustees, or federal funding regulations.

LEVEL OF WORK:

Entry.

SUPERVISION RECEIVED:

Close supervision from a higher level Auditor position.

SUPERVISION EXERCISED:

None.

LOCATION OF WORK:

May be used by any state agency.

JOB DISTINCTIONS:

Differs from higher level Auditor jobs by receiving close supervision during audit assignments and by having less decision making authority and less experience with an agency's audit program.

EXAMPLES OF WORK:

Serves as a member of an internal audit or field audit team.

Conducts audits for agency, including making arrangements for audits, maintaining files of all work papers, maintaining all appropriate documentation, and assisting in preparing report of audit findings.

Examines financial statements, journals, ledgers, monthly and quarterly financial reports, receipts, invoices, statements, charge memoranda, fee slips, and other individual financial transactions in reviewing information reported by audited entity.

As a member of an internal audit team, audits for procedural, statutory, program compliance, or operational effectiveness.

Conducts audits of A128 or A133 single audits for agency.

Inspects cash control records, payroll records, bank accounts, assets, liabilities, bidding procedures, inventories, disbursements, canceled checks, and the like to ascertain validity of information reported by audited entity and to determine dependability of its record keeping and reporting practices.

Determines a valid representative sample of financial transactions to audit and factors sample to project error rate or measurement of quality of entity procedures and prepares report of findings.

Reviews audit findings and report with superiors.

May assist as necessary in defending audit findings in formal adjudicatory hearings or informal forums concerning the audit findings.

Presents report of audit findings from the sample to appropriate managers.

Responds to inquiries from senior administrative staff members regarding audit activities and findings.

MINIMUM QUALIFICATIONS:

A baccalaureate degree with twenty-four semester hours in accounting.

SUBSTITUTIONS:

A certified public accountant (CPA) certificate or Certified Internal Auditor (CIA) designation will substitute for the baccalaureate degree with twenty-four semester hours in accounting.

NOTE:

Transcripts verifying any college semester hours in accounting necessary to qualify must be submitted with the application. Qualifying semester hours in accounting must be progressive course work. Credit will not be allowed for two accounting courses which cover essentially the same material.

AUDITOR 2

FUNCTION OF WORK:

To conduct financial and compliance or internal audits for an agency to ensure compliance with agency, state, or federal regulations.

To review and evaluate the effectiveness of procedures.

To measure compliance with agency directives.

NOTE:

For any application other than internal auditor, audit program must be required by statute, agency Board of Trustees, or federal funding regulations.

LEVEL OF WORK:

Journeyman.

SUPERVISION RECEIVED:

General supervision from a higher level Auditor professional.

SUPERVISION EXERCISED:

None.

LOCATION OF WORK:

May be used by any state agency.

JOB DISTINCTIONS:

Differs from Auditor 1 by responsibility for working independently in completing audit assignments and having greater experience with audit program.

Differs from Auditor 3 by absence of assistant supervisory or lead worker duties, responsibility to prepare majority of standardized audit reports, and absence of responsibility to prepare individual audit plan and program for each audit performed.

EXAMPLES OF WORK:

Serves as internal auditor of agency, auditing internal organizational units for procedural compliance, statutory compliance, and program compliance.

Conducts desk audits of A128 or A133 single audits for agency.

Assists in the development of annual audit program.

Independently conducts internal audits for agency, including making arrangements for audits, conducting entrance and exit conferences, maintaining files of all work papers, maintaining all appropriate documentation, and preparing report of audit findings.

Examines financial statements, journals, ledgers, monthly and

quarterly financial reports, receipts, invoices, statements, charge memoranda, fee slips, and other individual financial transactions in reviewing information reported by audited entity.

Inspects cash control records, payroll records, bank accounts, assets, liabilities, bidding procedures, inventories, disbursements, canceled checks, and the like to ascertain validity of information reported by audited entity.

Determines a valid representative sample of financial transactions to audit, factors sample to project error rate and measurement of quality of entity procedures; prepares report of findings.

Reviews audit findings and report with superiors.

Represents agency as necessary in defending audit findings in formal adjudicatory hearings or informal forums concerning the audit findings.

Presents audit findings to appropriate agency managers.

Responds to inquiries from senior administrative staff members of agency regarding audit activities and findings.

Performs operational audits of units and functions to determine operational effectiveness and efficiency.

Provides technical assistance to subcontractors, subgrantees, grant recipients, and other agencies regarding audit programs.

MINIMUM QUALIFICATIONS:

A baccalaureate degree with twenty-four semester hours in accounting plus one year of professional level experience in accounting or auditing.

SUBSTITUTIONS:

A certified public accountant (CPA) certificate or Certified Internal Auditor (CIA) designation will substitute for the baccalaureate degree with twenty-four semester hours in accounting plus the one year of required experience.

A master's degree with a major in accounting, business administration, finance, management, economics, quantitative methods, or public administration will substitute for the one year of required experience.

NOTE:

Transcripts verifying any college semester hours in accounting necessary to qualify must be submitted with the application. Qualifying semester hours in accounting must be progressive course work. Credit will not be allowed for two accounting courses which cover essentially the same material.

NOTE:

Any college hours or degree must be from a school accredited by one of the following regional accrediting bodies: the Middle States Association of Colleges and Secondary Schools; the New England Association of Schools and Colleges, Incorporated; the North Central Association of Colleges and Secondary Schools; the Northwest Association of Secondary and Higher Schools; the Southern Association of Colleges and Secondary Schools; the Western Association of Schools and Colleges.

AUDITOR 3

FUNCTION OF WORK:

To conduct financial and compliance audits for an agency to ensure compliance with the law.

OR

To serve as assistant supervisor in a unit of at least three Auditor 2 positions.

NOTE:

For any application other than internal auditor, audit program must be required by statute, agency Board of Trustees, or federal funding regulations.

LEVEL OF WORK:

Advanced Journeyman.

SUPERVISION RECEIVED:

General supervision from a higher level Auditor professional.

SUPERVISION EXERCISED:

None.

LOCATION OF WORK:

May be used by any state agency.

JOB DISTINCTIONS:

Differs from Auditor 2 by responsibility to prepare the individual audit plan and program for each audit performed, and responsibility for primarily preparing nonstandardized audit reports.

Differs from Auditor Supervisor by absence of direct line supervisory duties over an agency audit unit which consists of at least three subordinate Auditor positions.

EXAMPLES OF WORK:

Serves as assistant supervisor in a unit of at least three subordinate Auditor positions.

Assists in the development of the annual audit plan.

Independently conducts internal audits for agency, including making arrangements for audits, conducting entrance and exit conferences, maintaining files of all work papers, preparing individual audit plans, maintaining all appropriate documentation, and preparing a nonstandardized report of audit findings.

Examines financial statements, journals, ledgers, monthly and quarterly financial reports, receipts, invoices, statements, charge memoranda, fee slips, and other individual financial transactions in reviewing information reported by audited entities.

Inspects cash control records, payroll records, bank accounts, assets, liabilities, bidding procedures, inventories, disbursements, canceled checks, and the like to ascertain validity of information reported by audited entity and to determine quality of its record keeping and reporting practices.

Determines a valid representative sample of financial transactions to audit, determines necessary factors for statistical sampling to project error rate and quality of entity procedures, prepares report of findings.

Reviews audit findings and report with superiors.

Represents agency as necessary in defending audit findings in formal adjudicatory hearings or informal forums concerning the audit findings.

Provides technical assistance to entities being audited and other interested parties regarding the agency audit program.

Serves as a resource in training and development of lower level Auditor positions.

Develops operational audit programs to examine effectiveness and operating efficiency.

Accomplishes audits alone or as lead worker, and prepares nonstandardized audit report of findings.

Serves as lead auditor in conduct of A128 or A133 single audits for agency.

May serve as chief auditor of agency.

MINIMUM QUALIFICATIONS:

A baccalaureate degree with twenty-four semester hours in accounting plus two years of professional level experience in accounting or auditing.

SUBSTITUTIONS:

A certified public accountant (CPA) certificate or Certified Internal Auditor (CIA) designation will substitute for the baccalaureate degree with twenty-four semester hours in accounting plus one year of the required experience.

A master's degree with a major in accounting, business administration, finance, management, economics, quantitative methods, or public administration will substitute for one year of the required experience.

NOTE:

Transcripts verifying any college semester hours in accounting necessary to qualify must be submitted with the application. Qualifying semester hours in accounting must be progressive course work. Credit will not be allowed for two accounting courses which cover essentially the same material.

NOTE:

Any college hours or degree must be from a school accredited by one of the following regional accrediting bodies: the Middle States Association of Colleges and Secondary Schools; the New England Association of Schools and Colleges, Incorporated; the North Central Association of Colleges and Secondary Schools; the Northwest Association of Secondary and Higher Schools; the Southern Association of Colleges and Secondary Schools; the Western Association of Schools and Colleges.

The Audit Committee's "Top 10"

Today's audit committee members spend increasingly more time fulfilling their role than did their counterparts of yesteryear. Largely, this is due to scandals resulting from corporate malfeasance and subsequent regulations and legislation passed in an effort to rebuild stakeholder trust. The U.S. Sarbanes-Oxley Act of 2002 (SOX) moved select powers from the C-level suite to the audit committee. This transfer of power has required audit committee members to be more knowledgeable and more highly skilled, and to devote substantially more time and effort to their role. For many organizations in both the U.S. and around the world, time spent on audit committee work has doubled.

This edition of *Tone at the Top* discusses and provides commentary on Frederick Lipman's 10 best practices for audit committees. Taken from a more extensive list of 30 best practices delineated in Lipman's book, *Corporate Governance Best Practices*, these 10 practices originally were featured in *Financial Executive* magazine.

1. Establish effective internal auditing.

The primary responsibility of the internal audit activity is to assist the board in performing its fiduciary duty to monitor management — in other words, to act as the eyes and ears of the audit committee. Hence, establishing an effective internal audit activity with appropriate reporting relationships to the audit committee and the CEO is probably the most important action the audit committee can perform.

The audit committee is responsible for hiring and compensating the chief audit executive (CAE), and should consider structuring the compensation to avoid excessive reliance on compensation driven by accounting results. In other words, the CAE should not receive significant incentives based on profitability.

The audit committee must maintain control of the internal audit operations that deal with the auditing of financial reporting. The Institute of Internal Auditors

(IIA) believes the internal audit activity should maintain a balanced scope of work that examines risk from operational, financial, compliance, reputation, and strategic perspectives.

Sometimes an organization does not have all of the skills needed on staff and might outsource or "co-source" part of the internal audit activity. If a company enters into an internal audit outsourcing or co-sourcing arrangement, The IIA believes the in-house CAE should manage the process and projects.

2. Ensure organizational ethics.

A key element of creating an ethical, law-abiding culture within an organization without discouraging entrepreneurial risk-taking is the tone at the top of the organization. When those at the top "walk the walk," they set an example for openness and integrity. This sensitizes employees to the need to communicate significant legal risks to management and to the audit committee or nominating/corporate governance committee of the board of directors. The U.S. Department

Questions to Ponder

- How important are ethics within the operational structure of your organization?
- What is the tone of your organization's ethical culture?
- What do executive management and the audit committee do to help foster an ethical environment throughout your organization?
- Is an ethics policy and/or program in place?
- How are ethics and expectations of behavior communicated throughout your organization?
- Is an anonymous hotline or other reporting mechanism in place for reporting violations without fear of reprisal?



of Justice guidelines require the board to create an ethical culture to avoid criminal indictment of the organization, and sometimes, irreparable damage to its reputation. Financial incentives should be provided to the CEO to create such a culture.

3. Communicate.

Audit committees cannot operate properly without gathering information from diverse sources, both within and outside the company. On a yearly basis, the audit committee should interview the external auditors, the CEO, and the CFO. In addition, at least once a year, the committee should consider interviewing:

- The comptroller and assistant comptroller to determine whether they are uncomfortable with any accounting policies or procedures currently in place.
- The head of sales to learn about any side deals with customers, channel stuffing, or so-called “roundtrip” sales, etc.
- The tax manager to find out whether the company is pursuing any aggressive tax strategies.
- Inside and outside counsel.
- The disclosure committee chairman.
- The corporate governance officer.
- The head of information technology.
- The head of corporate development.
- The head of purchasing.

Something prosecutors have known for many years is that subordinates do not talk freely when their bosses are present. Each of the persons named above should be

interviewed separately and not in the presence of superiors within the company.

4. Monitor use of inside information.

The temptation to inflate earnings is greatest prior to the intended sale of stock by management. Audit committees should conduct more intensive and extensive audits on the eve of insider sale of significant amounts of stock. The audit committee should adopt a policy requiring written notice of insider sales several months before the actual date of such sales to arrange the necessary audits.

5. Notice red flags.

Other warning events should alert an audit committee to conduct more intensive and extensive audits. For example:

- Short sellers take a significant position in the company stock. Could they know something the audit committee doesn’t?
- The company never fails to meet an earnings projection. Is this realistic?
- The chief executive officer or chief financial officer is under personal financial pressure, which may stem from a lavish lifestyle, divorce, gambling habits, or other issues. Do large bonuses or salary increases depend on the company’s financial results?

6. Control conflicts of interest.

Should the audit committee ever elect to approve a conflict of interest, ongoing independent monitoring is essential. This may include more extensive audits by the external auditor, possibly supplemented by internal audit oversight. The external and internal auditors should report results directly to the audit committee. This is an important safeguard or internal control.

COSO’s Perspective on Communication

- | | | |
|---|--|---|
| <ul style="list-style-type: none"> • Pertinent information must be identified, captured, and communicated in a form and timeframe that enable people to carry out their responsibilities. • Information systems produce reports containing operational, financial, and compliance-related information that make it possible to run and control the business. These reports should deal not only with internally generated | <p>data, but also information about external events, activities, and conditions necessary for informed business decision-making and external reporting.</p> <ul style="list-style-type: none"> • Effective communication also must occur in a broader sense, flowing down, across, and up the organization. The staff must receive a clear message from top management that control responsibilities must be taken seriously. | <ul style="list-style-type: none"> • Personnel must understand their own role in the internal control system, as well as how individual activities relate to the work of others. They must have a means of communicating significant information upstream. • There also needs to be effective communication with external parties such as customers, suppliers, regulators, and shareholders. |
|---|--|---|

COSO: The Committee of Sponsoring Organizations of the Treadway Commission

COSO's Components of Internal Control

- Control Environment
- Risk Assessment
- Control Activities
- Information and Communication
- Monitoring

7. Ask questions.

The audit committee should ask the external auditors several key questions:

- If you were solely responsible for the company's financial statements, would you prepare them differently?
- If you were an investor, would the information the company has provided give you a proper understanding of the financial performance during the reporting period?
- Do you know of any operational facts that caused the company's sales or profit to vary significantly from one quarter to the next?

8. Ensure external auditor independence.

If the external auditor is not independent, both the company and the external auditor are in violation of the Securities Exchange Act of 1934. When adopted by the audit committee, the following policies will help ensure independence of the external auditor:

- The engagement letter should contain a representation that the external auditor is — and will remain — independent throughout the audit engagement.
- At least once a year, the audit committee will conduct a robust discussion with the external auditor about independence, including relationships with management that might impair objectivity.
- After conducting non-audit services, the external auditor must represent to the audit committee that those services do not impair independence.
- The hiring of a former employee of the company's external audit firm could jeopardize the external auditor's independence. The HR department will be required to notify the audit committee prior to hiring such an individual.

9. Seek tax services elsewhere.

According to Securities Exchange Commission rules, tax-planning services do not impair the independence of external auditors. However, the external auditor is prohibited by auditor independence rules from providing an expert opinion or other expert services for an audit client. The external auditor also is prohibited from acting as an audit client's legal representative in litigation or in a regulatory or administrative proceeding or investigation.

The effect of this prohibition is that the external auditor is unable to provide assistance in advocating the company's tax position before the Internal Revenue Service (IRS), since the IRS inquiry might be viewed as a "regulatory or administrative proceeding or investigation." Using the organization's external auditor in this way would handicap the company in the defense of its tax planning, and might not be in the best interest of the company.

10. Consider impacts.

SOX rules require the external auditor to disclose preferred accounting treatments. The audit committee must determine on a case-by-case basis whether these treatments should be adopted by the company, and what the overall effect would be.

If the audit committee decides not to adopt the external auditor's preferred treatment, it carefully should document the reasons for the rejection, with the assistance of counsel, in order to protect the audit committee members from personal liability.

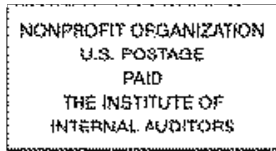
A SHORTCUT TO SUCCESS

It's safe to suggest that most people would not expect serving on an audit committee to be fun and games, but this list clearly is a tall order. How can audit committee members focus on all of these areas, while fulfilling their other roles? Can they possibly be effective with so much on their plates? And if they feel they must omit something, how do they go about choosing what to drop from the list?

Actually, there is a "shortcut," but it does not include cutting corners. Being diligent about the first item on the list can go a long way toward ensuring the other nine are covered.

An effective, professional internal audit activity can provide meaningful insights and assurance on all areas of risk, internal control, and governance. After all, when utilized to its best potential, that's what internal auditing is supposed to do.





TONEat**theTOP**



Mission

To provide executive management, boards of directors, and audit committees with concise, leading-edge information on such issues as ethics, internal control, governance, and the changing role of internal auditing; and guidance relative to their roles in, and responsibilities for, the internal audit activity.

Your comments about *Tone at the Top* are welcomed.

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Complimentary Subscriptions Available

You, your colleagues, and your audit committee and board members are invited to receive complimentary subscriptions to *Tone at the Top*. Send your request for printed or electronic versions of the newsletter to **pr@theiia.org** or write to us at:

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The Institute of Internal Auditors (www.theiia.org) is dedicated to the global promotion and development of internal auditing.

Established in 1941, The IIA is an international professional association with global headquarters in Altamonte Springs, Fla. The IIA has more than 150,000 members in internal auditing, risk management, governance, internal control, IT auditing, education, and security.

The IIA is the global voice, recognized authority, chief advocate, principal educator, and acknowledged leader in certification, research, and technological guidance for the internal audit profession worldwide. The IIA presents conferences and seminars, certifies qualified audit professionals, provides benchmarking, and through The IIA Research Foundation, conducts research projects and produces educational products.



AUDIT COMMITTEE BRIEFING...

INTERNAL AUDIT STANDARDS: WHY THEY MATTER

Why Do Internal Audit Standards Matter?

Internal auditing is one of the cornerstones of corporate governance, along with the board of directors, senior management, and external auditing. Because of internal auditors' unique position within the organization, they provide audit committee members with valuable assistance by giving objective assurance on governance, risk management, and control processes.

To do this effectively, an internal audit activity must be adequately resourced, professionally staffed, and follow the internationally recognized framework for internal auditing. Provided by The Institute of Internal Auditors (IIA), the *Professional Practices Framework (PPF)* comprises the *International Standards for the Professional Practice of Internal Auditing (Standards)*, Code of Ethics, and Practice Advisories.

For their part, audit committee members must play an active role in supporting the independence of internal auditing and ensuring it has enough resources to provide the appropriate level and quality of information. Commonly, and in best-practice organizations, internal auditing has a direct reporting line to the audit committee, which is frequently the most important of internal audit reporting lines.

The following overview explains how internal audit activities that adhere to the *Standards* and Code of Ethics can help audit committees comply with their own charters and regulatory responsibilities. Moreover, audit committees will find it much easier to execute their oversight responsibilities effectively in organizations where the internal audit activity complies with the *Standards*.

Because the *Standards* apply globally, including in countries that do not have audit committees, the *Standards* use the term "board" for the governing body typically serving the audit committee role. For purposes of this publication, the term "board" has been replaced with "audit committee."

In addition, this briefing provides guidelines for the relationship between audit committees and internal auditors and is a useful tool for anyone who wants to better understand the responsibilities, benefits, and qualities of an effective internal audit activity.

An effective internal audit activity acts as an independent, objective assurance and consulting activity designed to add value and improve an organization's operations.

"Today more than ever, audit committees need to work closely with internal auditors to ensure strong internal controls, accurate financial reporting, and adequate risk management in every company they serve. To work effectively with internal auditors, audit committee members need to know best practices for this vital function. By understanding internal audit standards, audit committees can strengthen their own work of oversight."

Roger Raber, CEO
National Association of
Corporate Directors (NACD)

How Do Internal Auditors and the Audit Committee Work Together?

To forge closer working relationships, as outlined in the *Standards* and various regulatory requirements for audit committees, the internal auditors and audit committee should examine their working relationship.

Audit committee members should ask themselves how much input they have to the leadership and work of their internal audit team:

- How well do I know the head of internal auditing? How often do I talk to him or her?
- Do I appoint the head of internal auditing? Does he or she report directly to the audit committee?
- When was the last time I reviewed the internal audit charter? Do I know what it says?
- Do I know how the internal audit activity sets its plan? Do I review and approve the annual plan?
- How well is the management team implementing actions agreed upon during internal audit work?
- If the chief audit executive (CAE) came to me and expressed concerns based on his or her business judgment, would I listen? How would I act?

Audit committee members should also examine the internal audit activity performance:

- Does the internal audit activity comply with The IIA's *Standards*?
- Is internal auditing's position in the organization at a sufficiently high level and sufficiently detached from functional areas to guarantee its independence?
- Do the internal auditors avoid activities that could undermine their objectivity?
- Is the internal audit plan based on the organization's risk profile?
- How well is the internal audit activity completing its plan this year?
- Does internal auditing have a quality assurance program? Does it have a plan to undergo an external quality assessment every five years as required by the *Standards*? What are the results of the most recent quality assessment?
- Is internal auditing sufficiently resourced to provide objective assurance on risk and control?
- How does the CAE respond to probing by the audit committee?

If You Do Not Know the Answers to These Questions, Now Is the Time to Ask.

Meeting Internal Audit Oversight Responsibilities

In recent years, the responsibilities of the audit committee have come under scrutiny or have been enhanced by regulators around the globe. In addition, audit committees frequently have stated roles related to internal auditing in their charters. The roles typically include monitoring the effectiveness of internal auditing. The Institute of Internal Auditors' *Standards* and Code of Ethics clearly outline what internal auditors need to do to be effective. An ever increasing number of regulatory bodies are recognizing the importance of this guidance in ensuring that internal auditing is effective.

The table below shows common charter or regulatory requirements regarding audit committee oversight of internal auditing, and the associated IIA Standard. This clearly illustrates that in organizations in which the internal audit activity complies with the *Standards*, the audit committee will find it much easier to comply with its own charter and regulatory requirements.

Audit Committee Internal Audit Oversight Responsibilities	IIA Standards
Reviewing and approving the internal audit activity's charter	"The purpose, authority, and responsibility of the internal audit activity should be formally defined in a charter, consistent with the <i>Standards</i> , and approved by the organization's audit committee."
Ensuring communication and reporting lines between the head of internal auditing and the audit committee	<p>"The chief audit executive should report to a level within the organization that allows the internal audit activity to fulfill its responsibilities." The IIA strongly believes that to achieve necessary independence, the chief audit executive should report functionally to the audit committee and administratively to the chief executive officer.</p> <p>"The chief audit executive should report periodically to the audit committee and senior management on the internal audit activity's purpose, authority, responsibility, and performance relative to its plan."</p>
Reviewing internal audit staffing and ensuring that the function has the necessary resources	<p>"The chief audit executive should communicate the internal audit activity's plans and resource requirements ... to senior management and to the audit committee for review and approval. The chief audit executive should also communicate the impact of resource limitations."</p> <p>"The internal audit activity collectively should possess or obtain the knowledge, skills, and other competencies needed to perform its responsibilities."</p>
Reviewing and assessing the annual internal audit plan	"The chief audit executive should communicate the internal audit activity's plans ... to senior management and to the audit committee for review and approval."
Overseeing the coordination of the internal auditor with the external auditor	"The chief audit executive should share information and coordinate activities with other internal and external providers of relevant assurance and consulting services to ensure proper coverage and minimize duplication of efforts."
Reviewing periodic reports on the results of the internal auditors' work	"The chief audit executive should report periodically to the audit committee and senior management ... Reporting should include significant risk exposures and control issues, corporate governance issues, and other matters needed or requested by the audit committee and senior management."
Reviewing management's responsiveness to internal auditing's findings and recommendations	"The chief audit executive should establish a follow-up process to monitor and ensure that management actions have been implemented effectively or that senior management has accepted the risk of not taking action."
Monitoring and assessing internal audit effectiveness	<p>"The chief audit executive should develop and maintain a quality assurance and improvement program that covers all aspects of the internal audit activity and continuously monitors its effectiveness."</p> <p>"External assessments, such as quality assurance reviews, should be conducted at least once every five years by a qualified, independent reviewer or review team from outside the organization."</p> <p>"The chief audit executive should effectively manage the internal audit activity to ensure it adds value to the organization."</p> <p>"The internal audit activity should evaluate and contribute to the improvement of risk management, control, and governance processes using a systematic and disciplined approach."</p>

Professional Internal Auditing

An effective internal audit activity acts as an independent, objective assurance and consulting service designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

Since 1978, the *Standards* and the Code of Ethics have set out the expected approach, principles, and behaviors that internal auditors apply to their work. Adopted by worldwide standard-setting bodies in the public and private sectors, as well as by all IIA members, the *Standards* and Code of Ethics are the profession's foundation and quality benchmark. By following the *Standards* and the Code of Ethics, internal auditors can provide an effective, independent assurance and consulting service to their organizations. Audit committees that are well-versed in the *Standards* and Code of Ethics will be in a better position to appoint, appraise, utilize, and support their internal auditors.

INTERNATIONAL STANDARDS FOR THE PROFESSIONAL PRACTICE OF INTERNAL AUDITING – A SUMMARY

The *Standards* describe the nature of internal auditing and the characteristics of parties performing internal audit activities. They also provide quality criteria against which the performance of internal auditing can be evaluated.

The **purpose, authority, and responsibility** of the internal audit activity should be defined formally in a charter, consistent with the *Standards* and approved by the audit committee.

The function should be **independent** and internal auditors should be **objective** in performing their work. In addition, all internal audits should be performed with **proficiency and due professional care**.

The internal audit activity, collectively, should possess or obtain the knowledge, skills, and other competencies needed to perform its responsibilities.

The chief audit executive should develop and **maintain a quality assurance and improvement program**, including internal and external quality assessments. He or she also should ensure the internal audit activity **adds value** to the organization and **follows a risk-based audit approach**.

In addition, internal auditing should **evaluate and contribute to the improvement** of risk management, control, and governance processes using a systematic and disciplined approach.

Before each audit, internal auditors should **develop a plan** that includes scope, objectives, timing, and resources.

During the engagement, internal auditors should **identify, analyze, evaluate, and record** sufficient information to achieve the internal audit project's objectives. Once the audit is complete, the results should be communicated in an accurate, objective, clear, concise, constructive, complete, and timely manner.

As a result, management should agree to take actions to improve their controls, and the chief audit executive should establish a **follow-up process** to monitor and ensure that these management actions have been implemented effectively.

INTERNATIONAL STANDARDS FOR THE PROFESSIONAL PRACTICE OF INTERNAL AUDITING – CONTINUED

When the chief audit executive believes that management has accepted a level of residual risk that may be unacceptable to the organization, he or she should discuss this with management. If the issue is not resolved, the chief audit executive and senior management should report the matter to the audit committee for resolution.

Note: Because the *Standards* apply globally, including in countries that do not have audit committees, the *Standards* use the term “board” for the governing body typically serving the audit committee role. For purposes of this publication, the term “board” has been replaced with “audit committee.”

THE CODE OF ETHICS – A SUMMARY

The purpose of the Code of Ethics is to promote an ethical culture in the internal audit profession.

- By acting with **integrity**, internal auditors establish trust and provide the basis for reliance on their judgment. Internal auditors perform their work honestly, observing the law, while contributing to the legitimate and ethical objectives of the organization.
- Internal auditors exhibit the highest level of professional **objectivity** in gathering, evaluating, and communicating information. Internal auditors make a balanced assessment of all relevant circumstances and are not unduly influenced by their own interests or by others. Internal auditors avoid activities and relationships that might be seen to undermine their objectivity.
- Internal auditors **respect the value and ownership of information** they receive and do not disclose information without appropriate authority, unless there is a legal or professional obligation to do so. Internal auditors should use information prudently and not for their personal benefit.
- Internal auditors **apply the knowledge, skills, and experience** needed for their role. They perform their work in accordance with the *Standards* and engage in continuing professional development.

A full copy of the *Standards* and Code of Ethics can be found at www.theiia.org/Guidance.

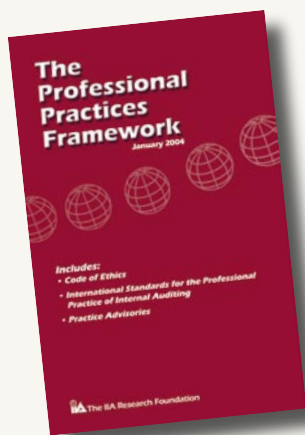
PROFESSIONAL PRACTICES FRAMEWORK

- *The Professional Practices Framework* – The IIA’s blueprint for the profession that offers practitioners a full range of internal audit guidance, including the *Standards*, Code of Ethics, Practice Advisories, and development and practice aids.

To access *the Professional Practices Framework* visit www.theiia.org/Publications click on “**IIA Bookstore**.”

- **Additional Resources** – Find the guidance resources you need in such areas as corporate governance, risk management, and establishing an audit shop.

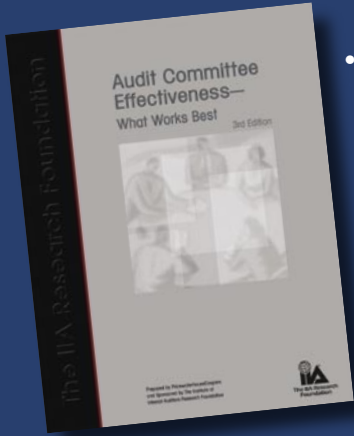
Guidance and resource information is accessible from The IIA’s Web site, www.theiia.org/guidance and www.theiia.org/technology.



Additional Resources

Audit Committees/Governance

PRODUCTS & RESEARCH FOUNDATION REPORTS



- *Audit Committee Effectiveness – What Works Best, Third Edition*
- *20 Questions Directors Should Ask About Internal Auditing?*
- *Audit Committees and Internal Auditing: An Essential Alliance for Effective Governance*
- *Corporate Governance and the Board – What Works Best*
- *Factors Affecting Corporate Governance and Audit Committees in Selected Countries (France, Germany, the Netherlands, the United Kingdom, and the United States)*
- *Governance Update 2003: Impact of New Initiatives on Audit Committees and Internal Auditors*
- *The Audit Committee Handbook, Fourth Edition*

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THE INSTITUTE OF INTERNAL AUDITORS

Established in 1941, The Institute of Internal Auditors (IIA) is an international professional association with world headquarters in Altamonte Springs, FL, USA. The IIA has more than 108,000 members and affiliates in 90 countries throughout the world. The IIA is the internal audit profession's global voice, recognized authority, acknowledged leader, chief advocate, and principal educator.

The International Internal Auditing Standards Board of The Institute of Internal Auditors sets the *International Standards for the Professional Practice of Internal Auditing* and the Code of Ethics.

For more information on The IIA's guidance,
visit **www.theiia.org/guidance**


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Perspectives on Enterprise Risk Management

 The Institute of Internal Auditors



THE AUDIT COMMITTEE:

A HOLISTIC VIEW OF RISK

KEEPING PRIORITIES IN ORDER

Certainly, it is an understatement to say that today's audit committee members have a lot on their plates. A quick glance at an audit committee meeting agenda will reveal far more issues than can be adequately addressed during the few short hours reserved for an audit committee session. It is likely that audit committee members sometimes leave their meetings feeling less than perfectly satisfied with the comprehensiveness of the information they have received, or the thoroughness of their discussions.

Given their broad range of oversight responsibilities, what can audit committee members do to determine their agendas and priorities are appropriate? How can they ensure that the most critical issues rise to the top and subsequently get the attention they deserve?

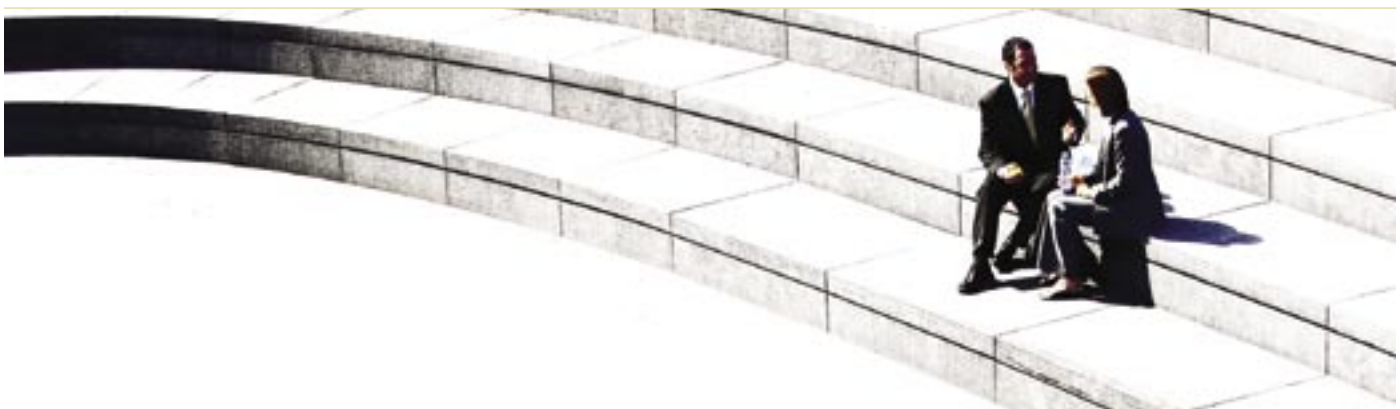
From a big-picture perspective, there is nothing more important to an organization's success — or to its very survival — than its ability to manage risks.

It has been said that every risk ultimately results in a financial risk. Surely, that has proven true in many business failures over the years. Failure to pay attention to day-to-day activities, changes in the economy, and the demands of consumers and regulators have resulted in immeasurable financial losses. And unheeded risks to an organization's reputation have brought many a company to its knees.

In a KPMG/National Association of Corporate Directors survey of public company audit committees, 80 percent felt that failure, resulting from poor risk management, couldn't happen to them. However, 50 percent thought it could happen to other companies. Could these statistics point to a blind spot?

Are you fully aware of your organization's overall risk strategy? Has it clearly been articulated and have the risks been made fully transparent to you? Can you affirm that the risk process is robust, independent, and fully aligned with your organization's overall strategy? Is a risk management culture instilled throughout the entire enterprise?

Clearly, knowing about and understanding both internal and external risks that can potentially impact the organization, and ensuring that these risks are managed to an optimal level, should be top priorities for board and audit committee members. This, in short, is enterprise risk management, or ERM.



WHY ERM IS IMPORTANT

Every entity, whether for profit or not, exists to realize value for its stakeholders.

Value is created by informed and inspired management decisions in all aspects of an entity's activities, from strategy setting to operations. Entities that fail to recognize the risks from both external and internal sources, and fail to manage those risks effectively can destroy value — in absolute or relative terms — for shareholders and other stakeholders, including the community and society at large.

Among the many outcomes of organizations' inability to effectively manage risks are bankruptcies, frauds, restatements of earnings, plummeting stock values, and loss of customers, careers, business partners, and overall credibility. Of course, managing risks optimally implies a balance between risk and reward — and clarification of acceptable risk thresholds.



ERM supports value creation by enabling management to:

- Deal effectively with potential future events that create uncertainty.
- Respond in a manner that reduces the likelihood of downside outcomes and increases the upside.

EFFECTIVE ERM:

- Is an ongoing, entity-wide process to identify, evaluate, analyze, respond to, monitor, and communicate on risks.
- Is effected by people at all levels.
- Occurs in strategy setting.
- Applies to every unit.
- Provides reasonable assurance.
- Enables continuous improvement in decision-making.
- Helps achieve objectives.

TRENDS TOWARD INTEGRATION

The Conference Board — the global research organization best known for its Consumer Confidence Index and Leading Economic Indicators — identified and documented, among others, the following trends. These trends support shifting a board’s focus toward ERM and its integration within the strategic oversight responsibilities of the board:

- Evolving legal developments, such as listing standards and regulations, make it prudent for directors to ensure they have a robust ERM oversight process in place.
- An increasing number of directors acknowledge they must oversee business risk as part of their strategy-setting role.

- Directors today believe strategic risk, rather than financial risk, is their key concern.
- Making ERM oversight improvements is critical to effective governance. Less than half of directors surveyed have access to robust techniques for risk oversight, and the majority do not use a ranking system as part of their risk assessment process.

ERM helps ensure effective reporting and compliance with laws and regulations and helps prevent losses — whether in the form of revenues or reputation. An ERM approach to risk is applicable to any organization, regardless of its industry or sector.

Inherent in the ongoing ERM process are a variety of activities that help an organization achieve its performance and profitability targets. These include aligning risk appetite and strategy, enhancing risk response decisions, reducing operational surprises and losses, identifying and managing multiple and cross-enterprise risks, seizing opportunities, and improving deployment of capital.



The Committee of Sponsoring Organizations of the Treadway Commission (COSO) states that ERM is a process, effected by an entity's board of directors, management, and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risk to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objectives.



COSO's *Enterprise Risk Management — Integrated Framework* defines essential components, suggests a common language, and provides clear direction and guidance for ERM. Enterprise risk management requires an entity to take a “portfolio” view of risk, which examines the entire organization, from the enterprise level to a division or subsidiary, to the level of a single business unit's processes.

COSO

COSO is a voluntary private sector organization dedicated to improving the quality of financial reporting through business ethics, effective internal controls, and corporate governance. COSO comprises five major professional associations: The Institute of Internal Auditors (IIA), the American Accounting Association (AAA), the American Institute of Certified Public Accountants (AICPA), Financial Executives International (FEI), and the Institute of Management Accountants (IMA).

COSO's FRAMEWORK

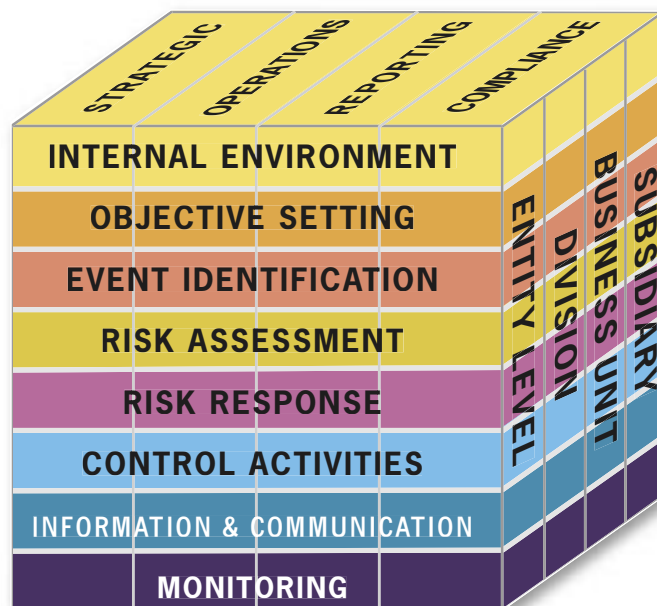
Within the context of an entity's mission or vision, management establishes strategic objectives, selects strategy, and sets aligned objectives cascading through the enterprise in four categories:

- Strategic – high-level goals, aligned with and supporting its mission.
- Operations – effective and efficient use of its resources.
- Reporting – reliability of reporting.
- Compliance – compliance with applicable laws and regulations.

This categorization of entity objectives allows a focus on separate aspects of ERM while taking a holistic approach to risk, and enabling management to consider how individual risks interrelate. The distinct but overlapping categories, as well as safeguarding of resources, address different entity needs and may be the direct responsibility of different executives.

ERM must be integrated with management processes. It examines eight interrelated components:

1. Internal Environment – management sets a risk philosophy and establishes the entity's risk culture and risk appetite.
2. Objective Setting – management considers its risk appetite in the setting of objectives.
3. Event Identification – management identifies the events, both internal and external, that present risk or opportunity to the organization. Opportunities are channeled back to strategy and objective-setting processes.
4. Risk Assessment – the likelihood and impact of risks are assessed to clarify the extent to which they might impact objectives. This employs a combination of qualitative and quantitative methodologies
5. Risk Response – management makes the decision as to whether the risk should be avoided, accepted, reduced, or shared; and then develops a set of actions to align the risks with the organization's risk tolerance.
6. Control Activities – policies are established to ensure management's risk responses are carried out effectively.
7. Information and Communication – thorough and timely communication takes place to ensure roles and responsibilities can be performed effectively in the process of identifying, assessing, and responding to risk.
8. Monitoring – ongoing ERM monitoring occurs, and modifications are made as warranted.



RISK INVENTORY

How does an organization begin to get a handle on risk and its effective management? According to The Conference Board, it is critical to take an inventory of risk factors pertaining to each driver of success.



The risk inventory should comprise financial (including market, credit, and liquidity risks and fraud), operational (including product risks, distribution channels, information security, and business continuity), business (including technological disruption, disintermediation, and competition changes), governance (CEO succession and compliance with laws and regulations), and human resource (employee relations and business conduct and ethics) risks.

RISK MANAGEMENT AROUND THE WORLD

COSO's ERM Framework was designed for global application, and many organizations in countries around the world have embraced it and use it as a basis for their risk management efforts.

Other ERM resources and frameworks include:

- Federation of European Risk Management Associations: www.ferma.eu
- Foreign and Commonwealth Office: www.fco.gov.uk
- Australian Standard 4360 Risk Management Portal: www.riskmanagement.com.au
- IIA-UK and Ireland Risk and Control Knowledge Centre: www.iaa.org.uk
- Risk Management Reports: www.riskreports.com
- Treasury Board of Canada's Integrated Risk Management Framework: www.tbs-sct.gc.ca (search using keywords "Integrated Risk Management")

WHO'S RESPONSIBLE

Virtually no one within an organization is exempt from contributing to the effectiveness of ERM. Certainly, there's no substitution for establishing and maintaining high organizational standards in regard to ethical values and integrity of those who are hired. With this as a baseline, management and the board should ensure that risk management is embedded in everyday business decisions throughout the company on an enterprise-wide basis and that each aspect of the organization understands and owns its role in the ERM process.

While the board of directors provides monitoring, guidance, and direction, it is the CEO who has ultimate ownership for the organization's ERM. The CEO works closely with senior managers to set the tone at the top, which shapes the organization's values, principles, and policies that influence all aspects of the ERM process. A cascading responsibility exists, and each level of management in the organization should stay informed on and take ownership of the risks at that level.

A risk management team may be led by the chief financial officer or some other designee of executive management and the board. In some organizations, a chief risk officer serves as part of the management team and is assigned a role in the ERM process as a key job

responsibility. This role, however, should be as facilitator or challenger. It is important for the organization to clarify roles so that all members of the management team understand their direct risk responsibilities.

Many corporate boards recognize a need for the organizations they serve to improve ERM capabilities. Based on extensive work in governance and risk, The Conference Board, together with McKinsey & Company and KPMG's Audit Committee Institute, makes six key recommendations for the effective oversight of ERM.

1. To begin with, whether assigned to the audit committee, a risk committee, or the full board, the responsibility for risk management oversight should be clarified, structured, and reflected in the charters.
2. The board should be well prepared to assume its oversight role by undergoing risk management training, participating in relevant discussions, and providing analysis of the organization's risk profile.
3. The organization's risk management process should include appropriate oversight of management's assessment of enterprise-wide risk, the controls in place to mitigate the risks, and the monitoring of risk.

4. An integrated reporting framework should consist of business unit reports aggregated to a company-level risk report, in conjunction with board reports.
5. A process should be in place to assess and monitor risk management performance, including addressing such issues as the effectiveness of committee structures and charters, the level of the board's understanding of risk policies, and the level of productivity of management and board communications.
6. There should be direct board interaction with the managers most acquainted with the organization's key risks.



INTERNAL AUDITING AND THE AUDIT COMMITTEE

The audit committee of the board of directors and the internal auditors are interdependent and should be mutually accessible, with the internal auditors providing objective opinions, information, support, and education to the audit committee; and the audit committee providing validation and oversight to the internal auditors.

A direct channel of communication between the chief audit executive (CAE) and the audit committee is essential.

The internal auditors regularly should report to the audit committee significant risk exposures and control issues, corporate governance issues, and other requested information.

The CAE and the audit committee also should meet at regular frequencies without management and the external auditors present. Clearly, the audit committee and internal auditors have interlocking goals, and should maintain a strong working relationship, mutual trust, and robust dialogue.

AUDIT COMMITTEE CHECKLIST FOR RISK MANAGEMENT OVERSIGHT

- Know the extent to which management has established effective ERM.
- Be aware of and concur with the organization's risk appetite.
- Learn who is responsible for risk identification, assessment, and management throughout the organization; and meet periodically with those individuals.
- Discuss with management how risks, including fraud risks, are identified and how those risks are assessed in regard to likelihood and impact.
- Understand internal auditing's role and planned coverage, and meet periodically with the CAE to discuss ERM.
- Review financial reporting risks, weigh them against the organization's risk appetite, and discuss with management how effective the controls in place are to mitigate those risks.
- Ensure all audit committee members are receiving the information needed in the appropriate format, so that effective evaluation of the risk management process can be made.

SOURCE: The IIA Research Foundation handbook, *Audit Committee Effectiveness-What Works Best*, 3rd Edition

The International Standards for the Professional Practice of Internal Auditing (Standards) include safeguards for the internal auditors to apply so that independence and objectivity are maintained when providing assurance and consulting services.

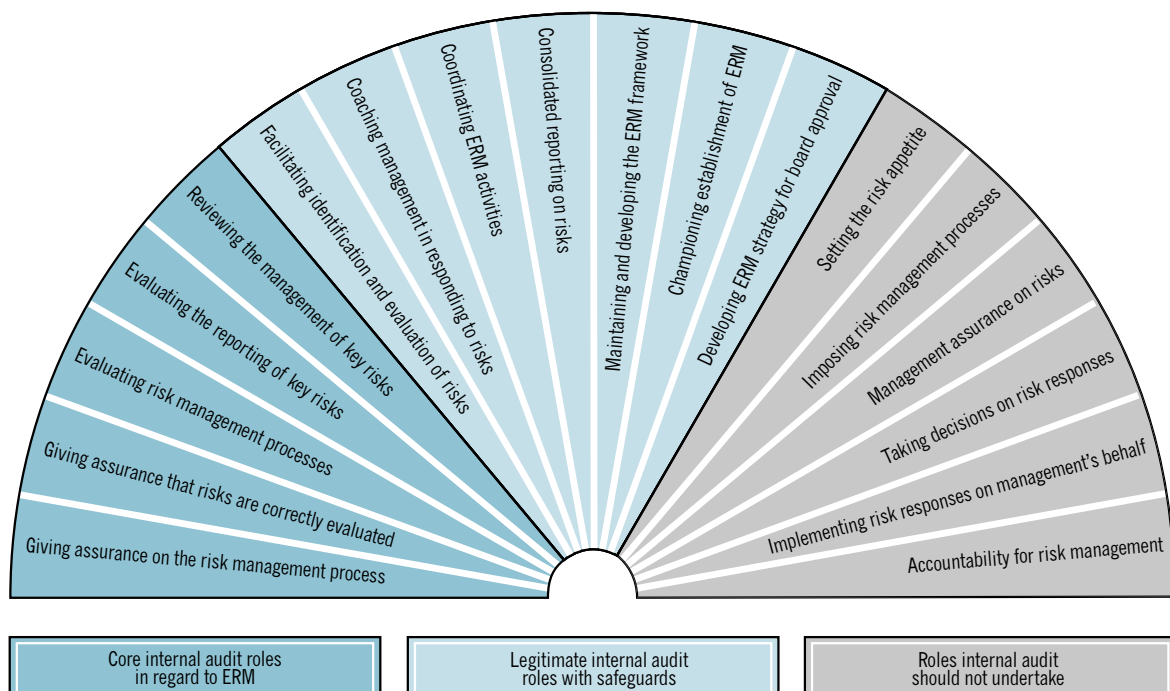
INTERNAL AUDITING'S VALUE TO THE ERM PROCESS

The Role of Internal Auditing in Enterprise-wide Risk Management, a position paper released by The Institute of Internal Auditors (IIA), discusses how the internal auditors add value. It identifies the two main factors a CAE should take into account when determining internal auditing's role in ERM. Does the activity raise any threats to internal audit independence and objectivity? Is it likely to improve the organization's risk management, control, and governance processes?

Although the internal auditors do not have primary responsibility for ERM implementation or maintenance, they play an important role in monitoring, examining, evaluating, and reporting on ERM. They also assist management and the board or audit committee by recommending improvements to ERM processes.

Internal audit activities may include:

- Reviewing the adequacy and effectiveness of the entity-wide ERM processes (including the processes to identify, analyze, manage, and report on risks) and providing recommendations for improvement.
- Reviewing critical control systems and risk management processes and responses for adequacy and effectiveness.
- Providing advice in the design and improvement of control systems and risk-mitigation strategies.
- Implementing a risk-based approach to planning and executing the internal audit process.
- Ensuring that internal audit resources are directed at those areas most important to the organization.
- Challenging the basis of management's risk assessments and evaluating the adequacy and effectiveness of risk-treatment strategies and the reliability of management's assurances.
- Providing assurances on the completeness, accuracy, and appropriateness of management's classification and reporting of risks.
- Facilitating ERM workshops.



A FINAL WORD

It is important to reiterate that enterprise risk management is not about eliminating risk. Without risk, there could be no change. And without change, growth could not occur.

ERM, however, takes a holistic view of organizational risks. This perspective

enables management and the board to assess their “risk appetite,” and to, based on intelligent examination, determine the level of risk throughout the organization they are willing to accept in pursuit of their mission or vision.

To fly, we have to have resistance.

– Mya Lin

FREE SUBSCRIPTION



Stay in the know about ERM and other issues critical to audit committees, boards, and executive management. The IIA's corporate governance newsletter – *Tone at the Top* – is available both electronically and in hard copy, free of charge.

Contact pr@theiia.org to ensure you receive this timely resource in the format of your choice. Please designate “Code E” when you make your request.

The IIA's guidance staff is available to respond to your questions about ERM and other governance issues. For more information, contact guidance@theiia.org at The IIA's global headquarters. Also visit the professional guidance section of The IIA's Web site at www.theiia.org for additional resources on risk, internal control, and governance.

THE INSTITUTE OF INTERNAL AUDITORS (IIA) is the acknowledged leader, recognized authority and chief educator for the profession worldwide. Established in 1941, The IIA has 246 affiliates around the world and serves more than 130,000 members in internal auditing, risk management, governance, internal control, IT auditing, education, and security in 160 countries.

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As the global voice of the profession, The IIA promotes quality, professionalism, effective governance, ethical business practices, and world-class internal auditing. Dedicated to providing extensive support and services to help internal auditors add value across the board, The Institute delivers best-practice guidance and information to internal audit practitioners, executive management, boards of directors, and audit committees all around the world.



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