

# tone at the TOP

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EXCLUSIVELY FOR SENIOR MANAGEMENT, BOARDS OF DIRECTORS, AND AUDIT COMMITTEES

## A New Level of Audit Committee Involvement

Involvement implies inclusion, engagement, commitment, and connection. In its purest form, true involvement cannot occur without all of the above. And yet, some audit committee members of the past may not have demonstrated this level of involvement in fulfilling their role and carrying out their oversight responsibilities.

The National Association of Corporate Directors (NACD) and KPMG recently released a new study, "The Audit Committee Journey: Recalibrating for the *New Normal*." Members of public company audit committees were surveyed to determine how their expectations, involvement, and performance might be changing in light of the current financial crisis.

The survey indicates that, in addition to improving their overall effectiveness, audit committee members primarily will focus on four top priorities over the coming year:

- Understanding and monitoring the impact of the financial crisis.
- Overseeing the effective management of risks.
- Ensuring clear and accurate financial reporting.
- Fostering and maintaining a strong internal control environment.

This issue of Tone at the Top looks closely at these priorities and how they relate to the internal audit activity. At the end of this newsletter is an invitation for those at the top to provide feedback on their involvement with and oversight responsibility for the internal auditors.

### HANDS-ON INVOLVEMENT

To meet the challenges posed by the economic crisis, three out of four public company audit committee members surveyed indicated that they have increased their active involvement with management. This is evidenced by the fact that they hold more formal and informal meetings with management. They spend more time in frank discussions with management, questioning and testing what they hear and what they assume. They are diligent about acquiring quality information that provides a clear picture of the way things are. In addition to getting information from a variety of sources, they also visit key units and offices to see for themselves.



The internal auditors are critical to the quality of information received by the audit committee. Because of their inherent independence and objectivity, their understanding of the corporate culture; and their integrity, discernment, and insights; the internal auditors are ideal conduits of information for the audit committee. They also can put together educational sessions for management to help engage the entire organization in good practices and information sharing.

## RISK MANAGEMENT OVERSIGHT

Few areas in any sector are getting as much attention these days as is an organization's risk management. And risks — whether they are financial, operational, strategic, technology-oriented, associated with fraud, related to compliance, or endangering to reputation — lurk throughout an organization. Among other benefits, effective risk management enhances an organization's ability to meet objectives, helps define the risk appetite, leads to informed decision-making, and helps ensure effective allocation of resources and management time. Oversight of all of this is part of the sometimes daunting role played by the board, and more specifically, its audit committee.

### The Fear Factor

According to the survey, today's audit committees are fearful that:

- They don't really understand the link between strategy and risk.
- Management does not have a holistic view of the many risks that could adversely affect their organization.
- The responsibilities for risk oversight are not clearly delineated.
- Assumptions about risk are not rigorously tested.
- There is not a clear understanding of the impact the organization's culture has on its risk profile.

To eliminate fears and ensure diligent and effective risk management, those responsible for organizational governance must be able to rely on a competent and trustworthy internal resource, capable of accurately assessing the effectiveness of the processes in place to manage and mitigate risks. That resource is the internal audit activity. The internal auditors have a keen perspective on an organization's vulnerability to a broad variety of risks; and can provide assurance as to how strong the system of internal controls is, where the gaps might be, and what changes might be required to ensure the system is consistent with the



organization's risk tolerance quotient. The internal auditors' roles include identifying, prioritizing, and monitoring risks; assessing the effectiveness of controls; providing ideas and recommendations for improvement; and reporting.

### How do you know whether your organization's processes to manage risk are effective?

The internal auditors assess whether:

- Organizational objectives support and align with the organization's mission.
- Significant risks are identified and assessed.
- Appropriate risk responses are selected that align risks with the organization's risk appetite.
- Relevant risk information is captured and communicated in a timely manner across the organization, enabling staff, management, and the board to carry out their responsibilities.

SOURCE: Practice Advisory 2120-1

Clearly, risk management is a complex, multi-dimensional process, and effective risk oversight requires diligence on the part of many. Full board involvement is essential. For this reason, NACD formed a new Blue Ribbon Commission on Risk Governance, which will release its report in the fourth quarter of this year.

## ACCURATE FINANCIAL REPORTING

For today's audit committee members, feeling confident about

their oversight of financial statements, internal controls, and compliance is not sufficient for a good night's sleep. Survey respondents indicate that, as a result of the financial crisis, uncertainties have surfaced in regard to whether policies and earnings guidance are appropriate. Some audit committee members worry about the accuracy of disclosures, the thoroughness of the information they get, and whether they receive reports often enough. And more than a third of survey participants are concerned about the adequacy of their organization's preparedness, in case an independent investigation might be warranted.

The internal auditors can provide assurance on all of these worries. The *International Standards for the Professional Practice of Internal Auditing (International Standards)* are one of the “mandatory” components of the International Professional Practices Framework (IPPF). This authoritative guidance is an internal auditor activity’s blueprint for addressing each and every concern an audit committee member may have. In other words, the assurance provided by internal audit practitioners who adhere to the *International Standards* is based upon structured and authoritative guidance, set by the Internal Audit Standards Board and vetted with all appropriate entities. This, in itself, should provide comfort to audit committees, who sometimes feel uneasy and need assurance about organizational effectiveness and efficiency, as well as evidence of proficient monitoring and accurate reporting capabilities.

## A STRONG SYSTEM OF INTERNAL CONTROL

It is imperative that the audit committee is satisfied that the organization’s system of internal control is strong and effective. Because each organization is unique in its makeup, culture, goals, risk profile, and management style, appropriate internal controls cannot be pulled from a rack labeled “One size fits all.” Rather, they are highly dependent upon the control environment, and consist of any action taken by management, the board, and other parties to manage risk and increase the likelihood that established objectives and goals will be achieved.

### What is the control environment?

According to The Institute of Internal Auditors’ (IIA’s) IPPF, a control environment comprises the attitude and actions of the board and management regarding the significance of control within the organization.

It provides the discipline and structure for the achievement of the primary objectives of the system of internal control, and includes:

- Integrity and ethical values.
- Management’s philosophy and operating style.
- Organizational structure.
- Assignment of authority and responsibility.
- Human resource policies and practices.
- Competence of personnel.

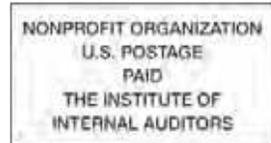


Internal auditors’ primary role is to help ensure organizational goals and objectives are met. Although their responsibilities and contributions are much more complex than space here will accommodate, simply stated, the internal auditors are tasked with assessing and monitoring risks, determining whether policies and procedures are being followed, recommending ways to improve organizational efficiency and effectiveness, and ensuring that the controls in place are adequate to mitigate the risks. In short, they serve as management’s and the audit committee’s safety net.

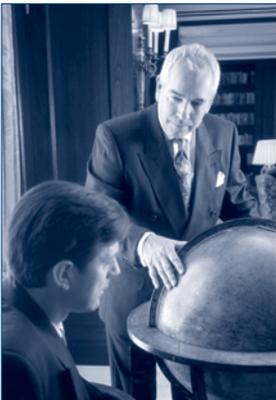
The internal auditors are the in-house resource for accurate and objective assessment, information, and insights; assurance, based on their unique knowledge, experience, and diligent pursuit of the truth; and ultimately — peace of mind.

## AUDIT COMMITTEE PERSPECTIVES

Because The IIA is dedicated to ensuring internal auditors bring the greatest value to management and the board, we invite you to share your views with us. If you are a member of your organization’s executive management team, board of directors, or audit committee, please take a few minutes to **complete a short survey regarding internal auditing’s role with the audit committee**. Your participation and perspectives will be invaluable, as The IIA continues to provide up-to-date guidance and support for the global internal audit profession. The online survey can be accessed here: <http://www.theiaa.org/survey>.



## 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.

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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 enhances the professionalism of internal auditors and is internationally recognized as a trustworthy guidance-setting body. It fosters professional development, certifies qualified audit professionals, provides benchmarking, and through The IIA Research Foundation, conducts research projects and produces educational products.