Brought to you by the publishers of COMPLIANCE WEEK

INSIDE THIS PUBLICATION:

Charting a New Course for Internal Audit

An e-Book publication sponsored by acl

transforming audit and risk

COMPLIANCE WEEK

Compliance Week, published by Wilmington Group plc, is an information service on corporate governance, risk, and compliance that features a weekly electronic newsletter, a monthly print magazine, proprietary databases, industry-leading events, and a variety of interactive features and forums.

Founded in 2002, Compliance Week has become the go-to resources for public company risk, compliance, and audit executives; Compliance Week now reaches more than 60,000 financial, legal, audit, risk, and compliance executives.

acl
transforming audit and risk

ACL delivers technology solutions that are transforming audit, compliance, and risk management. Through a combination of software and expert content, ACL enables powerful internal controls that identify and mitigate risk, protect profits, and accelerate performance.

Driven by a desire to expand the horizons of audit and risk management so they can deliver greater strategic business value, we develop and advocate technology that strengthens results, simplifies adoption, and improves usability. ACL's integrated family of products—including our cloud-based governance, risk management, and compliance (GRC) solution and flagship data analytics products—combine all vital components of audit and risk, and are used seamlessly at all levels of the organization, from the C-suite to front line audit and risk professionals and the business managers they interface with. Enhanced reporting and dashboards provide transparency and business context that allows organizations to focus on what matters.

And, thanks to 25 years of experience and our consultative approach, we ensure fast, effective implementation, so customers realize concrete business results fast at low risk. Our actively engaged community of more than 14,000 customers around the globe—including 89% of the Fortune 500—tells our story best. Visit us online at www.acl.com

Inside this e-Book:

Accounting and Audit Suffering Talent Shortage

By Tammy Whitehouse

With the improving economy and increased regulatory burden, accountants and auditors are in high demand once again. And a shortage of talent to meet that demand could continue to push up audit costs.

"There's no doubt, it's truly a war on talent," says Paul McDonald, senior executive director at Robert Half. While the general unemployment rate is at 5.9 percent, for accountants and auditors, it's 2.4 percent. "And that number continues to decline," he says. Regulatory demands are increasing the workload, especially in the financial services sector. "A lot of it is regulatory and compliance work."

Staffing shortages were most acute at the onset of efforts to comply with the Sarbanes-Oxley Act, says Richard Chambers, president and CEO of the Institute of Internal Auditors, when companies simply had to cope with large numbers of vacant positions. But he sees the crunch now in specific sectors and geographic areas. "New York has chronic challenges because of the heavy emphasis there on financial services and the compensation rates there," he says. Atlanta, Charlotte, and Chicago are also seeing a tighter accounting labor market, Chambers says.


McDonald

For internal audit specifically, tight staffing arises not only because of the shortage of accounting talent but also because of changes in the demands on internal audit that require specific operational or industry experience, Chambers says. "If companies were looking just for accounting talent, it might be easier," he says. "If you're trying to recruit specific skills in a specific market, it might be a little tight. Some companies have to broaden the search outside the immediate geographic area."

Costs are on the rise as a result of the tight market, says Trent Beekman, senior vice president at staffing firm Parker & Lynch. "Within reporting and auditing, the cost has gone up in the range of 15 to 20 percent in the last 12 to 18 months because of the labor market alone," he says. That's taking into account not just salary costs, which Robert Half reports as rising 3.5 percent for accounting and auditing in 2015, but also the "soft costs," of recruiting, training, staffing transition, outside contract services, and other needs. Audit Analytics reported recently that external audit fees took an upward turn in 2013 for the first time in several years, and audit experts cited the tight labor market as a factor.

Talent Exodus

While the regulatory demands are creating more work for accountants and auditors, some are wondering if it also discourages accountants and auditors for remaining in or entering the profession. Accounting has become more judgmental, with more focus on difficult estimates, just as regulators have clamped down on auditors with an increasingly arduous inspection process. Add to that the constant threat of litigation and the requirement for audit partners to rotate assignments every five years, which may require relocation, and it's easy to see why some accountants are heading for the door.

"The profession is aware of some of the perceived challenges facing those who choose to enter the auditing field," says Cindy Fornelli, executive director of the Center for Audit Quality. "The profession is making its way through a time of regulatory change, including mandated audit partner rotation, and responding to an intensive inspection pro-

Continued on Page 13

WORLDWIDE PROFESSION

Below, the AICPA offers some tips on how to "position the CPA as a premier of the accounting and finance profession throughout the world."

In a world of increasing interdependence and connectivity, the CPA is a premier accounting and finance designation. A growing number of CPAs believe it is increasingly important for the profession to be aware of global business issues and trends. Globalization offers unprecedented opportunities for the profession to expand into new markets. Yet globalization also brings challenges including greater competition for CPAs, both in the U.S. and internationally.

Technology will enable U.S.-based businesses of any size to conduct business abroad, while also enabling new overseas competitors, including non-CPA accounting professionals, to gain access to the U.S. market. Research shows that many CPAs anticipate continued outsourcing of accounting services and business processes. Additionally, organizations will be able to hire employees from a global workforce, as the CPA designation grows.

CPAs also will face increasing complexity with varying standards and customs across the globe. CPAs must navigate through different communication challenges and business practices while maintaining the highest ethics and standards that define the CPA profession. As global business becomes more complex, there will be an opportunity for CPAs to become the leading experts for all financial needs.

CPAs believe that maintaining the rigor and quality of the CPA credential will help uphold its positive perception and help the profession thrive overseas. Maintaining high standards for acquiring the credential and placing increased emphasis on continuing education as well as developing soft skills will help position the CPA as one of the world's premier designations.

IMPACT ON THE PROFESSION

1. CPAs must be increasingly aware of international business issues and trends.
2. CPAs must assess the trend toward outsourcing overseas and create opportunities to expand services to serve these markets.
3. CPAs must continue to market the quality and value of their services in order to expand and thrive globally.

Source: AICPA.

Internal Audit Attempts to Serve Many Masters

By Tammy Whitehouse

Internal auditors can probably identify with a famous quote by Homer: "If you serve too many masters, you'll soon suffer."

Under a market-driven mandate to look beyond internal controls, internal audit is finding it tough to determine just where to leverage its expertise and how to act as an advocate for the business, while preserving independence to provide unvarnished assurance.

Getting that balance right is tricky, say those on nearly all sides of the debate, and it's different for every company. Management, audit committees, regulatory demands, and even internal auditors themselves often bring different, sometimes competing, perspectives regarding how the internal audit function can best serve the company's needs.

Apart from new demands on their skills, the traditional workload on internal audit isn't getting any lighter, either. A recent study by Grant Thornton suggests internal auditors have become bogged down in meeting regulatory demands. One-third of chief audit executives said they believed increasing regulation is making it difficult for them to rise above the baseline of assuring regulatory compliance to also provide audit services or advisory services that might help the company improve operations or efficiency.

And then there are the competing ideas about the role and value of internal audit. According to a recent study by PwC, the various groups with a stake in internal audit are operating under different expectations of what internal audit can or should do, and how successful they are in doing it.

The PwC survey, for example, shows nearly 80 percent of board members believe internal audit adds significant value to the company, while only 44 percent of management holds that view. And that gap appears to be growing: In the prior year only 68 percent of board members and 45 percent of management saw significant value. As for internal audit's performance in meeting expectations, only 56 percent of board members and 37 percent of management rank internal audit performance as strong. That metric also declined from the previous year, when 64 percent and 49 percent of directors and managers, respectively, said internal audit preformed at the highest level.

Financial crisis and economic strife have led boards and management alike to call on internal audit to evolve past the internal control checking that marked the Sarbanes-Oxley Act era. They're trying, the data suggests, but are facing new regulatory demands and different performance expectations, making it difficult, says Warren Stippich, partner and GRC leader for Grant Thornton. "Stakeholders have to step back and consider all the competing interests," he says. "As a deliverer of internal audit, you're darned if you do and darned if you don't when you're trying to build a world-class internal audit function."

Jason Pett, U.S. internal audit services leader for PwC, says audit committees are generally looking to internal audit to assure compliance with regulatory requirements, while management increasingly wants internal audit to help identify and correct problem with operational effectiveness. "Internal audit has to be a master to all," he says. "That creates problems. If you're a master to one, there's a clear disconnect in terms of the value you get from the function."

Denny Beresford, former chairman of the Financial Accounting Standards Board now retired from five corporate boards, says he saw the constant challenge to balance the internal audit function on a "three-legged stool" directed by management, the audit committee, and internal audit itself. With internal audit still reporting to someone within the company for purposes of compensation and performance reviews, internal audit can't be fully independent of management, he says. "Under the best of circumstances, there are communication challenges," he says.

Pulled in Different Directions

The divergent data on the performance and expectations are disappointing to Bill Watts, principal and internal audit services leader at Crowe Horwath. "Internal audit is not fully positioned today to meet the demands, the perceptions, and the vision of the board," he says. "It's not necessarily internal audit's fault. The market has shifted so quickly in so many directions."

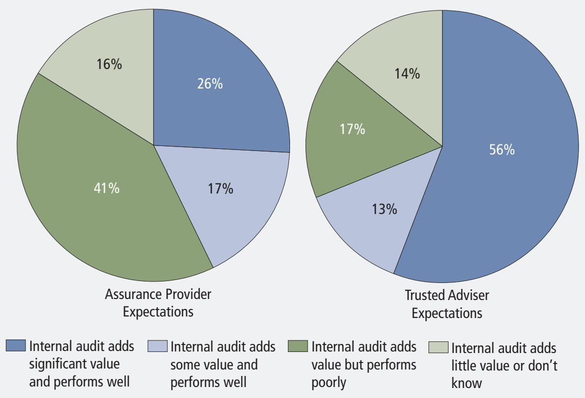
The recent data gives internal audit a new mandate to become more proactive in communicating with both management and the board about where the department is focusing its resources, says Pett. "Through interviews, the chief audit executives need to try to boil down what internal audit should be doing," he says. "They need a clear theme, and they need to drive alignment early in the year. You're not going to have perfect agreement, but you need alignment."

In a PwC Webcast to discuss the firm's survey results, John Fazio, who chairs the audit committee at Sequenom

Continued on Page 12

EXPANDING THE EXPECTATION SET

Below are two charts from PwC comparing stakeholder perceptions of internal audit departments with Assurance Provider expectations and those with Trusted Advisor expectations.



Source: PwC.

When Compliance, Audit Execs Blow the Whistle

By Tammy Whitehouse

Compliance executives have been more concerned about whistleblowers ever since the Securities and Exchange Commission opened its Whistleblower Office in 2012 to process tips from individuals deep inside companies. Now those executives may be the ones blowing the whistle.

That's because regulators are dangling the carrot of a big pay day in front of compliance officers and internal auditors for reporting misconduct at their companies.

The Securities and Exchange Commission recently, and proudly, announced it has given its first whistleblower award to "a company employee who performed audit and compliance functions." The $300,000 jackpot was to reward the individual for reporting concerns to the SEC when the company failed to take action on those same reports internally. The SEC's order granting the whistleblower's claim gives no detail on the nature of the misconduct, the company where it occurred, or the identity of the whistleblower, all of which is meant to assure that the person cannot be identified.

The order indicates that the whistleblower reported a problem internally, then took it to the SEC when the company failed to act, which led to an investigation and an enforcement action. The order grants the whistleblower 20 percent of the sanctions the SEC is collecting from the company.

Sean McKessy, chief of the SEC's Whistleblower Office, wants auditors and compliance officers to know that he's happy to take their phone calls. "Individuals who perform internal audit, compliance, and legal functions for companies are on the front lines in the battle against fraud and corruption," he said in a statement. "They often are privy to the very kinds of specific, timely, and credible information that can prevent an imminent fraud or stop an ongoing one. These individuals may be eligible for an SEC whistleblower award if their companies fail to take appropriate, timely action on information they first reported internally."

The award is striking a nerve among legal experts about the extent to which those front-line compliance and audit professionals are or should be eligible for whistleblower awards. "I definitely think the SEC is trying to send a message with this," says Gregory Keating, a shareholder with law firm Littler Mendelson and co-chair of the firm's whistleblowing and retaliation practice. "And on some levels it's troubling to the employer base I represent. We would expect these people to be the eyes and ears to look out for these very problems for us."

Under rules establishing the SEC's whistleblower program—a part of the Dodd-Frank Act—anyone with original information on corporate misdeeds can report them directly to the SEC and become eligible for a whistleblower award of 10 to 30 percent of any money the SEC might collect under an enforcement action. Companies protested the allowance of whistleblowers to go directly to the SEC before reporting matters internally, but to no avail.

Strings Attached

The rules do not apply in the same way, however, to compliance and audit, says Allegra Lawrence-Hardy, a partner with law firm Sutherland, Asbill & Brennan. "Under the regulations, there are exceptions to the general rule that would preclude whistleblower awards for employees whose duties include compliance and internal audit," she says.

If someone in that capacity reports a matter internally but sees no action in 120 days, they are eligible to become an SEC whistleblower. And they are eligible without waiting the 120 days if they believe that getting the SEC involved is necessary to prevent something that would cause great harm, or if they believe the company is doing something meant to impede an investigation of the misconduct. That means companies are now reminded that 120 days is an important deadline, says Lawrence-Hardy. "It's a really important reminder of the need for prompt action," she says.


Lawrence-Hardy

The SEC believes 120 days is a reasonable amount of time for companies to initiate action on a credible tip, especially if it comes from internal audit or compliance, says David Wilson, a partner with Thompson Hine. "The job of internal audit is to report internally," he says. "The takeaway is that companies need to take these complaints very seriously. You have to act quickly to separate the wheat from the chaff."

Jeff Alberts, a partner with law firm Pryor Cashman and a former assistant U.S. attorney in New York, says it's clear the SEC intended to send a message with its latest whistleblower award. "They want to make sure compliance professionals understand that this opportunity is available to them," he says.

Continued on Page 13

EXCEPTIONS

Below are the three exceptions in the whistleblower regulation that enable auditors and/or compliance professionals to become whistleblowers:

1. You have a reasonable basis to believe that disclosure of the information to the Commission is necessary to prevent the relevant entity from engaging in conduct that is likely to cause substantial injury to the financial interest or property of the entity or investors;

2. You have a reasonable basis to believe that the relevant entity is engaging in conduct that will impede an investigation of the misconduct; or

3. At least 120 days have elapsed since you provided the information to the relevant entity's audit committee, chief legal officer, chief compliance officer (or their equivalents), or your supervisor, or since you received the information, if you received it under circumstances indicating that the entity's audit committee, chief legal officer, chief compliance officer (or their equivalents), or your supervisor was already aware of the information.

Source: Cornell University Law School.

Internal Audit Looks Past Finance for Leadership

By Tammy Whitehouse

The evolution of internal audit from a function primarily concerned with financial risks to one that covers a broader array of risks is compelling companies to look for internal audit leaders with more diverse backgrounds and work experiences, who bring to the post a broader set of skills.

It's not uncommon these days for companies to pluck executives from operational units, IT, or other departments and turn them into audit executives.

In fact, a recent study by the Institute of Internal Auditors finds that 42 percent of chief audit executives in North America entered their current position from outside the internal audit profession. Only 20 percent of CAEs say they held prior management positions in accounting or finance. Of those who said they arrived at their current positions from outside of internal audit, more than half held prior positions in manufacturing, and nearly half had backgrounds in insurance, health services, and educational services. Roughly a third also had experience in the financial services or energy sectors.

As internal audit executives move beyond financial risks, many are finding it increasingly challenging to look at operational risks with the same skills sets and backgrounds, says Brian Christensen, executive vice president at Protiviti. "Boards and management are becoming more knowledgeable and more fluent on the broad topic of addressing risks, so they're looking to the chief audit executive to assist in assessing those risks," he says. "That expands beyond financial reporting to operational areas."

The demand for internal audit to examine operational risks drives the need for CAEs who have broader business experiences and can communicate effectively in the boardroom, says Emmett Lange, principal at internal audit services firm Sunera. "They need more highly tuned communication skills so they can provide more meaningful recommendations," he says. "The chief auditor needs to know what will work and what will not work, so they need operational skills and the gravitas to effect change."

It's a bit of a return to the days before the Sarbanes-Oxley Act, says Bill Watts, principal and internal audit services leader for Crowe Horwath. Companies back then expected internal audit to mind the bottom line more than the internal control structure, so operational experience was important. "Before Sarbanes-Oxley, you used to have many in the CAE role who were non-auditors," he says. "When SOX came along, they didn't have the skill set or the understanding to manage that new paradigm." So companies returned to accounting- and control-oriented individuals to lead internal audit, says Watts.


Watts

After clamping down on controls over the past decade, now companies are looking for a more balanced approach, agrees Chris Denver, a director for internal audit advisory firm Sunera. "Generally career auditors need to have more developed analytical skills," he says. "They need to be able to derive valuable information out of data and communicate it back to the organization in an efficient fashion. Someone who's not a career auditor can really drive a fresh perspective to the organization."

Been There, Done That

Bailey Jordan, a leader in Grant Thornton's GRC services unit, says someone coming from a functional area of the business is likely to be respected by those who will

Continued on Page 12

SKILLFUL INTERNAL AUDITORS

Below, the Institute of Internal Auditors describes what skills are required of a successful internal auditor:

Top 5 IA Skills Sought by Global Recruiters

The results of the *2012 Global Pulse of the Internal Audit Profession* survey conducted by the IIA's Audit Executive Center deliver dramatic confirmation of how much the requisite skills for internal auditors have changed. Chief audit executives are no longer lined up at the doors of their local universities to bid for newly minted accounting graduates. Instead, today's internal audit job postings are apt to look for people with non-traditional skills to fill vacant positions. Of the five most sought-after internal auditor skills by global recruiters, only one covers a technical area:

1. Analytical and critical thinking (selected by 72 percent of respondents)
2. Communication skills (57 percent)
3. IT general skills (49 percent)
4. Risk management (49 percent)
5. Business acumen (43 percent)

Seven Secrets of Success

If internal auditors are to help improve the company, their most important capability may boil down to understanding (and responding to) the reality that the world, and its companies, are changing constantly and quickly as new risks can emerge virtually overnight. Given the pace and magnitude of change, agility and flexibility are far from the only attributes leading audit executives seek. Other highly valued non-technical capabilities include the following:

1. Integrity
2. Relationship Building
3. Partnering
4. Communications
5. Teamwork
6. Diversity
7. Continuous Learning

Source: Institute of Internal Auditors.

Technology and the Evolving Role of Internal Audit

Creating a Whole New Level of Value

Written by John Verver

In recent years much has been said and written about the evolving role of internal audit. There have been two central themes: increasing relevancy and value to the organization overall, as well as determining internal audit's role in relation to risk-management processes. Internal audit's traditional focus on assurance over internal controls is still clearly important, since the effectiveness of controls is an essential part of how an organization manages risks. But many in the profession are seeking to do more and put their work more directly into a context of what really matters to an organization and its ability to achieve its strategic goals.

Given the unique role of internal audit this does not seem to be an overly ambitious goal. After all, what other function has such broad access and potential insight into activities that occur throughout every part of the organization? Of course, just being in a unique position does not necessarily mean that this translates into an ability to contribute at a whole new level of value. But if you add two more factors into the mix, it becomes easier to appreciate the tremendous opportunity for internal audit and those involved in other risk-oriented functions to transform their level of contribution to an organization. These two factors are technology and data. Most auditors share professional characteristics such as an ability to analyze, critique, and assess the risks of "what could go wrong"—as well, of course, as to make recommendations on a better way to do things. If you take these characteristics and connect them with (a) access to virtually unlimited amounts of data that reflect every aspect of the organization's activities and (b) technology to make sense of this data in the context of assessing a universe of risks, you are left with a remarkably powerful combination with tremendous potential for delivering highly valuable insights.

The importance of technology and data to the future of the internal audit profession is reflected in just about every survey performed by the Big Four and the IIA in the past seven years. The vision of internal auditors as highly sought-after professionals who embrace data and technology in innovative ways is already gaining traction in some organizations. Though there are, of course, some challenges to the vision. PwC's 2014 State of the Internal Audit Profession Study reported that only 40 percent of CAEs and 35 percent of senior management consider that internal audit is "leveraging technology effectively in the execution of audit services." But the expectation is clearly there that technology should be a great enabler for all internal auditors.

IIA's Three Lines of Defense and Imperatives for Enhancing Internal Audit's Value

It is interesting to note that those internal audit teams that are showing leadership in their use of technology for assessing and monitoring risks are also likely to be those that are best addressing the IIA's "Five Imperatives for Enhancing Internal Audit's Perceived Value" as defined in the IIA Audit Executive Center's Pulse of the Profession Report. The third imperative is: "Implement or enhance existing methodologies for assessing risks continuously." What better way to achieve this goal than for internal audit to play a lead role in the use of technology to identify and continuously assess risks, particularly through data analysis and other monitoring technologies? Internal auditors have historically played a big role in driving the whole concept of continuous auditing and monitoring, which lies at the core of continuous risk assessment.

The vision of internal auditors as highly sought-after professionals who embrace data and technology in innovative ways is already gaining traction in some organizations. Though there are, of course, some challenges to the vision.

A Leadership Role for Internal Auditors

The fourth imperative is for internal audit to, "Assume a leadership role in coordinating and aligning the activities of functions in the organization's second line of defense." Many organizations have clearly struggled to implement risk-management and compliance processes that take a consistent enterprise view and avoid the "silo" effect of multiple individual functions looking at risk, control, and compliance issues solely from their own perspective, often using a selection of standalone systems. In those cases where internal audit has already established its credibility in implementing technology and data-driven auditing approaches, it seems to be a natural next step to share its knowledge and techniques with those in the second line of defense and arrive at a coordinated and consistent approach for managing audit, risk, controls, and compliance across the organization.

In cases where internal audit has not progressed far in its use of technology and a data-driven approach, it can still make good sense for audit to play a key role in making sure that both the second and third lines of defense—and perhaps the first line of defense as well—are taking a consistent integrated approach that reflects different roles and responsibilities but avoids duplicated and unaligned efforts.

A Consistent Enterprise Approach to Managing and Understanding Risks

The overall vision is for all aspects of the organization to be taking a common approach to identifying and assessing risks, at all levels, driven in large part by the ongoing analysis of business process transactions and other data from across the organization. This allows for a constant assessment of whether existing controls and risk mitigation efforts are working effectively, together with the ability to identify new and changing risks, and to respond accordingly. Although parts of this process may be driven from within different functions in the second and third lines of defense, the goal is to be able to monitor and assess relative risk consistently across the organization. This enables the C-suite, board, and risk and audit committees to achieve a level of insight and understanding that is otherwise very difficult to achieve. It becomes another critical part of an overall business performance dashboard.

A Better Way to Audit

The IIA's fifth imperative for enhancing internal audit's perceived value is to "find innovative ways to enhance internal audit efficiency." Technology can clearly be a tremendous enabler for transforming audit efficiency and approaches. Some audit teams have made great progress in this area, in some cases having used a technology- and data analysis-driven approach for many years. However a large number of audit organizations still rely on "home-grown" MS Office-based systems to manage their audit processes. Others use traditional audit management software that often does not easily support a data-driven audit approach. Internal audit's use of audit management software often also lags behind other parts of the organization in terms of embracing newer technologies that really enable a far more efficient audit approach—the use of mobile devices and cloud-based systems being just two examples.

The overall vision is for all aspects of the organization to be taking a common approach to identifying and assessing risks, at all levels, driven in large part by the ongoing analysis of business process transactions and other data from across the organization.

Enhancing the Value of Internal Auditors

By using technology to respond to these three imperatives, as well as addressing the second imperative for the development of "robust knowledge and talent acquisition activities," internal audit can effectively address the first, namely, "assess apparent gaps in stakeholder expectations of internal audit's focus and capabilities." A technology-driven approach to audit, risk management, and compliance across the organization—with internal audit as a leader and coordinator—provides a great opportunity for internal audit to transform itself and not just meet, but exceed, expectations. For those audit professionals who become leaders in embracing technology, it is easy to see how their skillsets and insights can cause them to become sought after, not just within the audit function, but throughout the organization due to the value they bring.

About the author
John Verver, CPA, CISA, CMC, Strategic Advisor to ACL
John Verver is an acknowledged thought leader, writer and speaker on the application of technology for audit, fraud detection, risk management and compliance. He is recognized internationally as a leading innovator in continuous controls monitoring and continuous auditing and as a contributor to professional publications. He is currently a strategic advisor to ACL, where he has also held vice president responsibilities for product strategy, as well as ACL's professional services organization. Previously, John was a principal with Deloitte in Canada.
www.acl.com

What's the Auditor's Role in Investigating Fraud?

By Alix Stuart

In theory, auditors are a formidable opponent to corporate criminals seeking to cover up their misdeeds.

Armed with professional skepticism and the authority to interrogate data and employees, both internal and external auditors could reasonably be expected to be on the forefront of uncovering illegal activity.

Sketchy accounts payable journal entries, for example, could be a tip-off that a company is paying bribes to government officials—triggering an FCPA investigation—or kickbacks to a competitor, which could lead to a price-fixing investigation.

Major financial frauds, like overstating revenues or manipulating the balance sheet, also live within the lines of financial statements. Considering how closely auditors scrutinize such files, it seems only logical they might stumble across illegitimate payments, tampering, forgery, or evidence of some other form of money-related crime and ferret it out.

In reality, that's rarely the case, audit experts say. Among the fraud cases that come to light, internal auditors discover it approximately 14 percent of the time, according to a recent survey by the Association of Certified Fraud Examiners, while external auditors uncover the misdeeds in just 3 percent of cases (5 percent at larger companies), which is less often than it is discovered by accident.

Rarer still is it that an auditor would go outside the company or directly to regulators, despite the fact external ones are legally required to do so in certain cases. That's not to say that external auditors are looking the other way or casting a blind eye to fraud. Instead, auditors generally follow their protocols, raise the issues with management or the audit committee or both, and then ensure that someone else is doing the appropriate investigating.

Escalate, Not Investigate

The applicable law governing external auditors and investigations is Section 10A of the 1934 Securities Exchange Act. That section, created in 1995 as part of the Private Securities Litigation Reform Act and amended by the Sarbanes-Oxley Act, requires auditors to consider any potentially illegal act they come across in their audit, whether or not it is perceived to have a material effect on the client's financial statements.

They are to first determine whether it is likely an illegal act has occurred, then estimate the financial effect (including potential fines), and then "as soon as is practicable" inform management about the issue, ensuring the audit committee hears about it as well. If—after an unspecified period of time—the auditor believes it is a material issue and management is not taking action, the audit firm must issue a "10A report" to the board, send the report to the Securities and Exchange Commission, and resign from the engagement.

The Public Company Accounting Oversight Board Audit Standards 316 and 317 also address the issue of illegal acts by clients, including financial statement fraud. While these standards stress that financial auditors are not usually equipped to determine whether non-financial activities are illegal, they also set out detailed protocols for what to do when things don't seem right. The first step is to talk to the managers at the level above those involved in the suspicious behavior, or to the audit committee in the case of senior management. If the auditor is not satisfied with the response, he or she should ask the client to arrange for discussions with the client's legal counsel or other specialists, and then "apply additional procedures" such as comparing supporting records with accounting statements to see if they match up.

If the activity still appears to be illegal and management does not take the allegations seriously, then the auditor must consider resigning. As for informing the SEC or other regulators, however, the standards advise auditors to be cautious. "Disclosure of an illegal act to parties other than the client's senior management and its audit committee or board of directors is not ordinarily part of the auditor's responsibility, and such disclosure would be precluded by the auditor's ethical or legal obligation of confidentiality," the standards read, except in circumstances such as when a subpoena is served.

> "A company's compliance and internal audit should be the first line of defense against corruption, not part of the problem."
>
> Kara Novaco Brockmeyer, Chief, Foreign Corrupt Practices Act Unit, SEC Enforcement Division

The Company's Response

Generally speaking, companies respond quickly to an auditor's concern with some form of an internal investigation, attorneys say. "Most public companies today take this very seriously, and they know they have to at least get things cleaned up between them and their auditor," says Jason Hille, a partner in the Milwaukee office of law firm Foley Lardner. "There is really no opportunity to sweep it under the rug."

Auditors then stay apprised of the investigation without being directly involved, says Tim Hedley, who is often involved in forensic accounting investigations as global fraud risk management leader for KPMG. "They know the work plan and what inquiries and document reviews we're doing as we go along, and then the conclusions we come to," he says.

The SEC does not make public the 10A letters that auditors may file in disagreement with management's responses. The most recent GAO report on 10A letters, completed in 2003, found that just 29 such letters had been filed between 1996 and 2003.

For their parts, the SEC and PCAOB rarely levy the sanctions against auditors for failing to find or disclose fraud or other illegal activity. One of the highest-profile cases in the past decade involving these issues occurred in 2011, when both authorities charged five of PwC's India affiliates for failing to verify forged bank deposits of client Satyam, a large Indian company that was charged with overstating revenues by about $1 billion. PwC India settled the charges, paying $6 million in SEC penalties and $1.5 million in PCAOB penalties. Beyond that, most 10A-related cases have targeted very small CPA firms.

To some extent, the lack of action is understandable, given the scope of auditing. "Auditors are tasked with making sure the financial statements don't have any material omissions or mis-statements," says Hille. "If you see something marked 'special payment,' that might be a yellow flag, but for every 10 [illegal payments], you probably have 10,000 transactions that were legitimate."

That could change with the use of Big Data-style analyses, but not likely very much. "Auditors will use analytics and technology during the course of an audit, but normally audit procedures are not designed to detect illegal acts," says Hedley. Something like filtering accounts payable to spot suspicious anomalies and trends would only occur under "very specific facts and circumstances," not necessarily as a standard part of an audit.

Some of the most spectacular financial disasters, however, have strongly implicated auditors, and regulators have not always taken action. Consider Lehman Brothers, whose meltdown and subsequent bankruptcy fueled the financial crisis that began in 2009. One catalyst was the fact that the bank improved its balance sheet through the use of so-called Repo 105 transactions that temporarily removed some debt to minimize the firm's leverage.

In his lengthy report, unsealed by the courts in 2010, bankruptcy examiner Anton Valukas, head of law firm Jenner Block, notes that Lehman's auditor, Ernst & Young, "did not evaluate the possibility that Repo 105 transactions were accounting-motivated transactions that lacked a business purpose." Instead, the firm merely confirmed the fair value of such assets and assessed how well they adhered to the accounting standard at hand. Even when a credible whistleblower told E&Y officials that the firm had used $50 billion in Repo 105 transactions to manipulate the balance sheet the previous quarter, the auditors did not mention it at an audit committee meeting the next day. Valukas concludes "there is sufficient evidence" to support claims that Ernst & Young "was professionally negligent in allowing [the audit] reports to go unchallenged."

While Ernst & Young faced plenty of private litigation about its role, plus a lawsuit from the New York Attorney General's office that is still ongoing, neither the SEC nor the Department of Justice has brought charges against the audit firm.

Inside Jobs

Internal auditors are often held to a higher standard than external ones, since "they are more plugged in" to the company's operations, notes Hille. One of the best-known examples of how powerful their investigations can be is Worldcom, where then-vice president of internal audit Cynthia Cooper uncovered systematic financial fraud in her review of capital expenses. Other companies, including Avon, have more recently noted that internal audit findings have triggered investigations.

Internal audit executives who fail to escalate problems appropriately have also faced public fire from regulators. When the SEC brought FCPA charges against medical device manufacturer Biomet in 2012, for example, officials made special note of the fact that internal audit had rigorously documented illegal payments to doctors and government officials in countries such as Argentina, Brazil, and China, but failed to sound adequate alarm bells. "A company's compliance and internal audit should be the first line of defense against corruption, not part of the problem," said Kara Novaco Brockmeyer, chief of the FCPA enforcement unit, in the press release accompanying the charges.

As with external auditors, however, the main duty of the corporate auditor is to escalate a problem, not bring it directly to authorities. "Most large companies have a protocol, and everyone pretty much knows what their roles are when internal audit stumbles on a fraud," says Richard Chambers, president and CEO of The Institute of Internal Auditors. Internal audit's role, however, is not typically to bring issues to regulators. In the "extraordinarily unlikely" event that management or the audit committee was unwilling to report a crime that internal audit was aware of, auditors "would have to weigh their actions very carefully and would probably want to engage their own counsel." ■

SEC. 10A. AUDIT REQUIREMENTS

Below is an excerpt from the Securities Exchange Act of 1934 explaining audit requirements.

REQUIRED RESPONSE TO AUDIT DISCOVERIES

INVESTIGATION AND REPORT TO MANAGEMENT: If, in the course of conducting an audit pursuant to this title to which subsection (a) applies, the registered public accounting firm detects or otherwise becomes aware of information indicating that an illegal act (whether or not perceived to have a material effect on the financial statements of the issuer) has or may have occurred, the firm shall, in accordance with generally accepted auditing standards, as may be modified or supplemented from time to time by the SEC

(A)(i) Determine whether it is likely that an illegal act has occurred; and (ii) if so, determine and consider the possible effect of the illegal act on the financial statements of the issuer, including any contingent monetary effects, such as fines, penalties, and damages; and

(B) As soon as practicable, inform the appropriate level of the management and assure that the audit committee of the issuer, or the board of directors in the absence of such a committee, is adequately informed with respect to illegal acts that have been detected or have otherwise come to the attention of such firm in the course of the audit, unless the illegal act is clearly inconsequential.

Source: Securities Exchange Act of 1934.

Internal Audit Looks Past Finance for Leadership

Continued from Page 7

be audited because the audit leader knows what it's like in the trenches. "Someone coming out of the business is more likely to be able to be consultative," he says. "They have the street smarts of someone who's been there and done that."

Another plus, says Charlie Wright, vice president of internal audit at Devon Energy, is experience with the audit from the perspective of the functional managers whose work is being audited. Wright himself has had a dual career in auditing and in information technology, giving him perspective on the demands from both angles. "It helps to understand if you've been on the other side of the table what the business managers' expectations are, and what they're going through," he says.

That doesn't mean a company is best served by appointing a CAE with no accounting or auditing savvy, says Rob Kastenschmidt, national leader of risk advisory services for McGladrey. "You can't ever have a CAE who lacks accounting familiarity or doesn't understand accounting concepts," he says. "It's the language by which businesses talk within the company and with outside users. But having strong business function experience can trump a career solely in accounting," he says.

Acknowledging the benefit, there are risks to beware when bringing in audit leaders from outside the traditional accounting and finance proving grounds, says Richard Chambers, president and CEO of IIA. "A lot of time these individuals don't bring a strong knowledge of risk management or internal controls," he says. Even more worrisome, they may lack objectivity, he says, especially if they're serving in the CAE role as part of an executive development track where they expect to circulate out into the business in some leadership role in the future. "Just how objective can that individual be in that role if they know their future career assignment depends on the relationships they build?"

Mark Lindig, CEO of GRC services firm Accume Partners, says he's less concerned about independence than auditors who are too rigid. "People coming from audit have a very deep sense that no conflicts of interest are allowable," he says. "People coming from operations are more concerned with solving problems," he says. "I don't think it's that black and white." If either view is taken to its extreme, the internal audit function ultimately will be ineffective, he says. The key, he says, is for an effective audit committee to serve as the watchdog.

Jeff Browning, senior vice president and chief audit executive at Fiserv, says companies choosing someone from operations to run the audit function should be aware of what the audit leader doesn't know. "It's a steep learning curve from the governance perspective," he says. "There's no wrong or right answer here. It gets back to what the company is looking for in the audit function."

Jordan says companies choosing a CAE from outside of audit should take care to assure the audit function doesn't move too far into the direction of consultation, recommending improvements to the business to become more efficient or effective. "If you skew the audit plan to consulting versus compliance, there's a risk you might take your eye off the compliance assurance aspect," he says.

Audit committee oversight is vital to assuring the chief audit executive strikes the right balance, says Stephen Shelton, vice president of internal audit at KBR Inc. Audit committees need to have regular communication, formally and informally, with the CAE to achieve such oversight, he says. "They need to ask probing questions so they can assure they have more than a peripheral understanding of the risks that are included in the internal audit plan, how it was developed, and what might not be in the plan but was considered," he says. ■

Internal Audit Attempts to Serve Many Masters

Continued from Page 5

and Heidrick & Struggles International, said he doesn't ever expect to see perfect alignment of the expectations and performance assessment of internal audit because management is naturally closer to the process. He says constant communication with the internal audit department is crucial to getting better insight into what's happening.

Fazio, for example, says he gets better insight into the brief highlights in an internal audit report, especially in seeing areas that management would perhaps prefer to gloss over. "When reports are getting sanitized, I will find that out through the communication process," he says. "Then I know some of the questions I need to ask during an audit committee meeting to bring out some of the points that were written down or reduced a bit because of management sensitivity to them."

Sanitizing is perhaps a strong term for Phil Wedemeyer, chairman of the audit committee at Atwood Oceanics, a $1 billion offshore drilling company. "I haven't had a situation that amounted to anything where internal audit was filtering out things that were important," he says. "I'm sure some have." Certainly there's always plenty of talk about the reporting structure for internal audit and to what extent it affects what the audit committee sees and hears from internal audit, he says. "Part of their job is to communicate in a way that's comprehensive, not edited, not filtered. If I felt they were doing that, I'd have a real problem with that."

Wedemeyer definitely sees different expectations from management and the audit committee, with audit committees focused primarily on controls. "I look at that as a bedrock reason for having internal audit," he says, "to provide independent assurance within the company about how controls are operating." The idea of trying to drive internal audit to more of an advisory role is perhaps appropriate for larger companies, he says, but companies on the smaller end of the spectrum are more focused on the assurance aspects. ■

Accounting and Audit Suffering Talent Shortage

Continued from Page 4

cess. It has been a time of transition, which has impacted the profession in both positive and negative ways."

Accounting firms say they aren't seeing droves of late-career partners retiring early as a result of the increased demand, but firms do concede they have a tougher time retaining young hires and keeping them on the track toward partner. "The turnover is creeping up," says Jennifer Busse, a talent acquisition leader for McGladrey. "It stayed flat for a couple of years, but we are starting to have an uptick."

PwC feels it too. "We continue to learn and respond to what it takes to be successful in the current environment where expectations on all of our stakeholders are very high," says Donald Christian, assurance human capital leader for PwC. Disturbed by the rapid departure of "Millennial" generation recruits, the firm launched a global study to identify the issues.

Adapting to the Younger Set

The study found Millennials are more concerned about work-life balance, with more interest in flexible work schedules and less concern over pay increases and promotion than the generation before them. They are more interested in varied work opportunities, including assignments abroad, more in tune with the latest technology, and focused on having the right support and feedback. PwC has responded with recruiting and retention strategies that include interactive training, varied work assignments, increased use of technology, and various other innovations to adapt to the new workforce expectations, including pursuing more diversity, says Christian. BDO USA says it has responded to the demand for more varied work by using its network of member firms to facilitate inbound and outbound assignments.

Busse says she sees the generational effect, with younger hires less interested in sticking with public accounting, opting for better pay or fewer hours in other career tracks, especially in private industry. "Staffing agencies are crazy busy right now," she says, as auditors prepare for the busy season of year-end audit work. "It might even be easier for private industry to hire right now."

Turnover in middle levels, such as accountants with four-to-seven years of experience, creates great opportunity for growth for those who stick it out, says Jeffrey Agranoff, a partner with audit firm Friedman. "We identify superstars early, and put them on a much faster partner track now," he says. Staffing and pricing engagements gets tricky with the drain in the middle level as well. Partners or senior accountants with more experience are "working down" more than they'd like, he says, and that can mean higher billing rates.

The good news, according to the American Institute of Certified Public Accountants, is that universities are turning out growing numbers of graduates who are eligible to pursue the CPA credential, says Rebecca Mahler, senior manager. The number of students pursuing accounting degrees dropped off in the early 2000s, right around the time many states began increasing the number of credit hours required to earn a bachelor's degree in accounting, but the number of both bachelors' and masters' degrees awarded nationally spiked in 2012 to an all-time high since the early 1970s.


Agranoff

McDonald at Robert Half says the key for companies that are competing for accounting and audit talent is to pay attention first and foremost to retention. "Retention is easier than attracting," he says. "Managers should be sitting down and doing career mapping with their employees and reviewing salaries more frequently. What are the wants and desires of that individual? There are too many choices out there right now." ■

When Compliance, Audit Execs Blow the Whistle

Continued from Page 6

"They are potentially the most valuable whistleblowers. Second, the SEC wants to let companies know they need to act swiftly to complaints that are made. Companies need to focus more aggressively on this 120-day time line."

Andrew Rainer, of counsel with law firm Brody, Hardoon, Perkins & Kesten, says the SEC whistleblower program doesn't appear to treat external auditors differently from internal auditors. However, external auditors would report serious concerns directly to the audit committee, where there's naturally more leverage to get action. "If that happens, the chances of a company policing itself go up dramatically," he says. "It's different for an internal auditor to go up the chain."

The decision to be a whistleblower for an outside auditor is likely more difficult, says Diana Lloyd, practice group leader at law firm Choate, Hall & Stewart. "The practical question appears to be how outside auditors will weigh the value of a potential whistleblower award against the potential reputational risk associated with turning in a client to the SEC," she says. "In theory, the identity of whistleblowers is to remain confidential, but the risk of disclosure cannot be entirely eliminated."

John Fullerton, a partner with Epstein Becker Green, says the increased focus in recent years on whistleblower issues has raised some thorny issues with respect to retaliation claims that come from compliance and audit professionals. It's not always clear to employers how to release a compliance or audit professional for reasonable cause without invoking a retaliation claim.

"It can be frustrating for a [firm] when a person's job is to report internally, and then they suffer some kind of adverse employment action," he says. "The company will say we hired you to report, so we didn't retaliate against you for reporting. You were fired for some other reason. The law with respect to retaliation protections in auditor functions continues to develop." ■

Put your work in executive context

Complete Audit Management and Data Analysis Software

If you're like the majority of audit leaders, you spend your day struggling in spreadsheets, managing reviews in shared drives or email and chasing after tick marks in e-documents. You'd rather be putting strategic risks into executive context to add value for your organization. We've been there and that's why we created ACL™ GRC, the only audit management software that supports your full process from risk assessment and planning to field work and controls testing – with integrated ACL™ Analytics.

ACL's audit management system helps you:

- Break free of spreadsheets, shared drives, and email with end-to-end workflow
- Prove immediate value to executives with data-driven insight into strategic risks
- Drive decisions with analysis of actual transactional data using ACL Analytics
- Complete more audits in less time by streamlining processes and optimizing scheduling
- Take advantage of iPhone® and iPad® to complete reviews and capture evidence…anywhere

acl™

Learn more and take a test drive at acl.com/auditmanagement