

European

INTERNAL AUDIT BRIEFING

December 2008 · Issue 13

No time for regulation

Special report from the ECIIA conference in Berlin

INSIDE: Surviving the crunch – a new strategic role for internal audit?
Advocacy corner, people moves, news, events and more



New president takes the reigns

Elisabeth Styf took the reigns as ECIIA president at the body's annual conference this year in Berlin. Mauro Di Gennaro stepped down.

Styf said that the best way of promoting the role and visibility of ECIIA was to complete its work-in-progress activities from 2008. But, she said, there would be new emphasis on several issues.

In particular, she wants to improve the ECIIA website by implementing an advocacy corner, which would include a forum of exchange for all national institutes. The idea is that all national institutes will update information

on their own advocacy activities in order to share them with members in other countries in Europe.

In addition, she wants to set up a support group for new ECIIA members to facilitate greater networking and the exchange of information.

"It is very important to put internal auditing in the forefront of solutions to the global financial crisis in Europe," she said. A working party will look at the need for issuing position papers on internal audit and/or corporate governance by examining the work that is already underway in individual member countries.

Events

IIA Azerbaijan is organising an international conference entitled *Internal control and audit as a guarantee of transparency and efficiency*. Conference will be held in June 27-28, 2009 in Baku, Azerbaijan. The Institute is also celebrating its 10th anniversary.

Contact Elmar Alakbarov, secretary-in-chief at: audit-azerbaijan@azeurotel.com

People news

Several presidents of recently appointed member Institutes received their certificates at the annual conference in Berlin this year. Mircea Poenaru, president IIA Romania, Viljar Alnek, board member of IIA Estonia and IIA Iceland received their certificates for ECIIA membership. Each became a new member on 6 July 2007 at the ECIIA's General Assembly in Amsterdam.

Dr. Josef Bähr of Deutsche Bahn AG was elected to the board of directors of the DIRR on 18 November 2008. At the same time, Dr Manfred Lindner resigned from the board.



Mircea Poenaru



Dr. Josef Bähr

New links

The DIIR has relaunched its new-look website at: www.diir.de
The internal auditor in the Netherlands: Position paper update 2008 can now be found at:
www.iaa.nl/SiteFiles/PDF/paperworkengels.pdf



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Advocacy corner

One of the big issues exercising the minds of internal auditors and their organisations across Europe is the need to create audit committees for public interest entities. In October 2008, ECIIA got together with ecoDa (representing board directors), Business Europe and European Issuers (representing senior management in enterprise) and FEE (representing external auditors) to discuss the practical implementation of Article 41 of the 8th EU-Directive – the law that introduces this new requirement.

Participants identified three main areas of interest: the need for additional regulatory guidance at the EU-level; the respective roles of the supervisory and management boards; and, the need for board assurance on the effectiveness of organisational governance processes.

Members can read a bit more of the substance of these debates on our website. But one thing that emerged clearly was the need to steer away from prescriptive rules on assurance.

One participant voiced the view that the last thing organisations need is a rigid governance and risk management framework. This could lead to organisations pretending to “demonstrate”

the effectiveness of governance and risk processes, which would eventually be watered down into a mere “box ticking” exercise that added no value whatsoever. “Frameworks are not important, processes are,” said the participant.

From the subsequent discussion it became actually clear that none of the participants seemed to favour a rigid governance and risk management framework. In addition, there was broad agreement that assurance should not be restricted to controls around financial reporting, but include assurance on operational issues too.

Wrapping up the session, the moderator concluded that while there was some divergence regarding the interpretation/implementation of some specific issues addressed by Article 41, the debate identified several areas of common interest. The group expects to meet again to iron out differences and to create a list of “better practices” regarding the practical implementation of Art.41 from a Pan-European perspective.

For more information: www.eciia.org

**Send your advocacy stories
to: Arthur@sdw.co.uk**

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Global Assurance: Oversight and Insight to Risks and Opportunities

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To see the conference video [CLICK HERE](#)

No time for regulation



Berlin Potsdamer Platz

Governments are searching for solutions to the current global crisis, but speakers at this year's ECIIA annual conference in Berlin say more regulation is not the answer. Neil Baker and Arthur Piper report

The financial market crisis has pushed boardroom governance and risk management to the top of the global political agenda. But a principal architect of Europe's current corporate governance

culture", making it harder to deal with a root cause of the crisis.

Winter is the Dutch lawyer called in by the European Commission after the 2002 wave of financial scandals to work out how corporate governance in Europe

“What we don't need is a lot more regulation or legislation coming in from the US, such as another Sarbanes-Oxley Act”

framework has warned against trying to “fix” the system. Now is not the time to create more rules and regulations, Professor Jaap Winter told the ECIIA conference in November. That would only fuel a growing “compliance

needed to change. His report has guided European governance reform since then. Now he says that rather than blaming the governance and regulatory system for the current problems, and trying to repair it by creating »



Professor Jaap Winter: more responsible

» more rules or guidance, the focus should be on changing the behaviour of individual employees, finding ways of making them feel more responsible for their actions.

Winter said that errant human behaviour caused financial crises, not flawed systems. “No system has ever generated a crisis,” he said. “The first reaction is that the system has failed so we need new rules. We ask for more rules and more enforcement,

but we forget about our own behaviour: what is it in us that we continue to blame the system?”

Winter said increased regulation of financial firms and general corporates was leading to the “self-enforcement” of a compliance culture. There were already far too many rules for regulators to monitor and enforce, so they were outsourcing that work to companies themselves, he argued.

This growth in corporate



Miles Templeman: good corporate governance

compliance was having a pernicious effect: crowding out personal responsibility, Winter argued. “It is not helping us, it makes things worse,” he said. “What compliance is doing is making sure people follow rules. We forget about our own responsibility for our behaviour and replace it with responsibility for compliance.”

The answer was not to do away with rules and compliance,

said Winter, but to create a corporate culture based on responsibility and integrity.

Miles Templeman, the director general of the Institute of Directors in the UK, agreed that more rule making would not make the situation any better. “We have a good system of corporate governance,” he told the conference, “what we don’t need is a lot more regulation or legislation coming in from »

» the US, such as another Sarbanes-Oxley Act.”

He said that the current crisis would have an impact on corporate governance in general, but that its most dramatic effect in the short term would be on business confidence, particularly in the financial sector.

might be able to use the media to re-establish confidence and business’s sense of “legitimacy.”

Governments were severely questioning whether businesses are acting correctly in four main areas, he said. First, they were asking whether boards are made up of the right people and whether

“We ask for more rules and more enforcement, but we forget about our own behaviour: what is it in us that we continue to blame the system?”

While the financial sector had been criticised for taking too much risk, he said that the irony now was that it is too unwilling to lend to businesses, especially smaller ones. “There is a vicious circle created by a lack of confidence, which leads to a lack of investment and so on,” he said.

Templeman said that businesses underestimated the role that the media play in accentuating the perception of a problem, such as the current financial crisis. He urged companies to think how they

they are acting effectively? He believed that some companies did not have effective board chairman, which meant that the non-executive directors were often not used to the best of their abilities.

Second, many companies seemed not to be managing their risks properly, which he saw as a critical role for internal audit to play. Third, he said that while many members of parliament in the UK believed that massive bonuses were largely responsible for creating the conditions for the »

Bigger and better

The ECIIA Conference 2008 was held in Berlin on 20-21 November. It was organised by the Deutsches Institut für Interne Revision, the DIIR, which was also celebrating its 50th anniversary. Bernd Schartmann, president of the DIIR, said that there were more than 500 attendees at the event from over 40 countries, making it the biggest ECIIA event ever. Delegates came from as far a-field as Bahrain and Lithuania to Argentina and Indonesia and less than half were from Germany. There were key note addresses from the outgoing president of the ECIIA Mauro Di Gennaro, Professor Jaap Winter, the director general of the Institute of Directors Miles Templeman and the 2008-9 chairman of the global board of the IIA Patricia Miller. Delegates were treated to a night time tour of Berlin and a reception at the 1936 Olympic Stadium.



ECIIA – Eastern Europe

Internal audit in central and eastern Europe has changed beyond recognition since the collapse of the Soviet Bloc almost 20 years ago. And where better to reflect on the profession's progress than in Berlin, the city which for so many years marked the boundary between East and West.

Martin Wiedemann, a partner in the Moscow office of accountants Ernst & Young, led a conference session that discussed the role and development of internal audit practice in the east. The profession in each country had started from a unique position, and grown in line with domestic influences, explained Wiedemann, but practice was now converging. The main challenges that heads of internal faced would be familiar to their peers from other countries, he said.

The role of internal audit

changed as governments rapidly privatised state assets in a transition to capitalist economies, Wiedemann argued. In the past, management was often a majority shareholder in privatised companies, or retained control in government-owned organisations. There was no effective oversight of management by a supervisory board and no transparent reporting. Internal audit's role was to police the business.

Government and the public sector had been one of the biggest influences on the development of the profession, as the European Union required new member states to create an internal audit function in order to qualify for subsidies. Commercial companies were slower to catch-up, said Wiedemann; board directors and executive management took longer to realise the added value of an internal audit function.

Lately, however, leading

companies are increasingly trying to implement good corporate governance – and, therefore, good internal audit – so that they can access international capital markets. Boards are also using internal audit to perform a more enlightened role: rather than policing the business, they are monitoring the effectiveness and efficiency of the organisation.

However, heads of internal audit functions still face challenges, said Wiedemann. They need to explain the difference between internal audit and internal control and develop the internal audit function so that it monitors and advises on controls, and is not responsible for implementing and executing them, he said. They also need to convince management and board directors that internal audit adds value, and is not simply a cost centre: a challenge that internal auditors around the world face.

» credit crunch, this perception was “very far from the truth”.

While remuneration levels were “not totally unimportant,” they did not have the impact on behaviour that MPs often believed. On the other hand, remuneration committees did not have the profile of audit committees in the business world and were less

“Remuneration committees do not have the profile of audit committees in the business world and are less effective”

effective. He questioned whether some remuneration committees really understood the complexity of the pay structures in some financial institutions. The IoD is discussing a new code of practice on remuneration that will take a “comply or explain” approach to best practice. The final area that government was questioning was shareholder activism, which he said would “grow more out of the current crisis.”

To see a short film of the conference highlights, please [CLICK HERE](#).

Surviving the crunch

Dealing with the current economic uncertainty was a big theme at this year's ECIIA conference. Delegates received plenty of advice about the role internal audit could play in helping their organisations through the crunch. Arthur Piper and Neil Baker report

Internal auditors need to react to changing boardroom expectations of what the profession should deliver, especially in the wake of the current financial crisis, outgoing ECIIA president Mauro Di Gennaro said in his conference presentation.

Internal audit across Europe should be moving beyond its traditional territory of financial control, said Di Gennaro.

"Nowadays the expectation of senior managers and audit committee members is that internal audit will put a higher priority on strategic, operational and business risk," he said.

"These are often the primary

factors associated with rapid declines in shareholder value. We must have in our mind what they expect from us – we must react and adapt new

“Senior managers and audit committee members expect internal audit to put a higher priority on strategic, operational and business risk”

approaches to our daily work.”

Amid the current crisis, Di Gennaro said internal audit must “try to ensure that our voice is heard at board level.” Indeed,

the crisis could represent an opportunity for internal audit to contribute more. “We must be able to catch this opportunity to leverage our role,” he said.

“Internal audit acts as an architect in the planning and design of business and risk management strategy – we are an internal consultant and »



Mauro Di Gennaro



Patricia K. Miller: re-evaluate thinking

» business partner within the organisation. We must be able to catch hold of this opportunity for the growth of our profession.”

That would entail securing the trust of management, said Professor Jaap Winter. He told delegates to get the message across to people in their organisations that internal audit could do very little on its own: it had to work with management in a spirit of openness.

Internal auditors needed to make sure that they were recognised, trusted and valued, Patricia K. Miller, the 2008-9 chairman of the global board of the IIA, told the conference. She said that while recognition was the baseline goal for an internal audit department, trust would have to be earned.

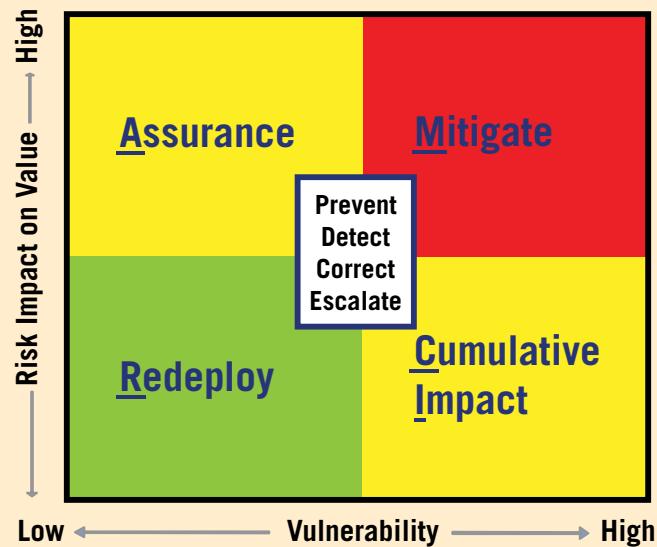
Now, more than ever, internal auditors would need to exhibit the highest integrity and ethics,

understand the business and the management’s strategy and objectives. She said that taking a compliance-only approach to internal audit would not be enough. For example, internal auditors might note that a bank reconciliation had not been completed, but they needed to ask, “what is the business objective you’re not achieving by not doing the reconciliation?”

She said that internal auditors

should re-evaluate the way they thought about risk following the credit crunch (See *New risk assessment approach*). She said that recent events had shown that risks that are low likelihood were often the ones that would really bring the organisation down because they could be so devastating if they occurred. “Internal audit’s best tactic is to make an organisation less vulnerable,” she said. »

New risk assessment approach



M = High Impact/High Vulnerability

- Provide assistance in design of controls where impact and vulnerability are high
- Track progress on remediation plans

A = High Impact/Low Vulnerability

- Obtain assurance confidence in preparedness is justified

R = Low Impact/Low Vulnerability

- Obtain assurance on effectiveness
- Identify ways to improve efficiency

CI = Low Impact/High Vulnerability

- Assess cumulative impacts and frequency



Phil Tarling: more challenge

» Phil Tarling, international partner at the accountancy firm RSM Bentley Jennison, said that there was not enough challenge from internal auditors on decisions that management were making. From an Eastern European perspective, in particular, not enough internal auditors were doing risk based audits and not enough managers were using risk in their everyday decision-making,

he said. “We need to promote a risk awareness culture in our organisations,” he added.

Miles Templeman, the director general of the Institute of Directors in the UK, said that given the uncertain financial prospects of many business sectors it was essential that internal audit had clear objectives. “The objective of internal audit is to make the company succeed in the longer term on behalf of

all stakeholders,” he said. “I’ve met too many internal auditors who want to be policemen first and secondly only achieving the goals of the company.”

He said that it was important that internal audit should have a close working relationship with

“That is why they need a good relationship, so that when a problem arises, they look at it in a more sympathetic light.”

Talking of the future challenges facing internal audit, Di Gennaro described a fast-moving business environment in

“Internal audit’s best tactic is to make an organisation less vulnerable”

the whole company – including the audit committee chair and the chief executive officer. “In order to do that, internal audit needs the right high calibre individuals,” he added. “It is difficult to be in a company and at the same time have the ability to stand back and analyse what is going on; but that is the task.”

He said that internal auditors had to ask the right questions, be brave and have the appropriate understanding of risk that is commensurate to the size of company in which they worked. “Some boards are often too resistant to the recommendations of internal audit,” he said.

which “it is difficult to focus on the real target of the company; it is easy to lose the vision of the whole design; it is even easier to produce something that is already obsolete.”

This was a high-velocity, high-risk business climate, he said, adding: “Internal audit must be able to transform risk from an unknown into something manageable, promoting at the same time an agile culture. Agile means more personal interaction, less bureaucracy, more cooperation – ready for change through automation, communication, customer involvement, design »

» and documentation and simplicity in approach.”

Di Gennaro encouraged conference delegates to be innovative in the way they

quickly its business changes strategy,” she said. “It needs to revise its own strategy to align with the new business reality.”

Asked about whether internal

“Internal audit needs to revise its own strategy to align with the new business reality”

performed internal audit.

“Innovative internal audit practice is a road, not a destination,” he said. “Internal audit by its very nature provides many opportunities for innovation in the service it provides. The emphasis on analytical and problem solving processes should encourage critical thinking and creativity.”

Jenny Morgan, partner at the consultancy firm KPMG, agreed that innovation would be important if internal audit were to add value to their organisations. She said that lots of businesses would be rethinking their strategies, including cutting costs. “Internal audit needs to keep up to date with how

audit could do a better job if it were more independent, Winter warned of the risks of becoming detached from the business. “Independence is a good thing, when we think from the perspective that if you have an interest you may have a bias that you don’t see,” he said. “The likelihood is that we all overestimate our objectivity; we are not sensitive enough to the biases that we carry with us. If you are in a relationship of dependence, naturally you will have a bias even if you don’t know it. From that point of view, the more independent you are the better.”

“But there is a risk that if you



Jenny Morgan: business reality

overemphasise independence, you become an outside agency, which for those inside the business becomes viewed as the enemy. The more independent internal audit becomes, the more they will be seen as bureau of internal investigation – the worst enemy. If you are not careful, you can create an environment where internal audit is seen as the one thing that you have to cheat on to get things done,” he said.

The trick was to strike the right balance between independence and involvement, said Winter, before adding: “I don’t know where the balance is.” ■

Our mission

- » To be the consolidated voice for the profession of internal auditing in a widely defined Europe by dealing with the European Union, its Parliament and Commission and any other European or global institutions of influence.
- » To represent and develop the internal auditing profession throughout the wider geographic area of Europe and the Mediterranean basin.
- » To represent the European internal auditing profession on the global stage in tandem – and in consultation – with IIA Inc.
- » To promote the profession in economically emerging countries, as appropriate, within the wider geographic area of Europe and the Mediterranean basin.

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