Audits Without Borders

Whether their assignments are domestic or offshore, internal auditors are rising to the challenge of an ever-expanding, global workplace.

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THE WORLD IS SHRINKING AT A BREATHTAKING PACE. Global travel, the Internet, and high-tech, wireless personal communications have made national borders fuzzier than ever, from a corporate perspective. The place where one company ends and another begins now is often delineated more by contracts and customs than by traditional notions of "us" and "them," or "domestic" and "offshored." ■ For internal auditors, the world of global commerce and blurry borders can make the old-fashioned, box-checking approach to auditing next to impossible, and it can make their more recent focus on evaluating governance and risk management processes even more so. The fluidity of the ties that bind organizations to

their web of offshored vendors, affiliates, and contractors may make yesterday's ties seem rigid and obvious, but those ties do still exist — and they still must be addressed when audit departments conduct risk assessments. Today's fuzziness requires internal auditors to address a host of new risks, in addition to their already expanding responsibilities. ■ Still, even as exactly what constitutes "internal" — from an internal audit perspective — continues to change, developments in the profession are making offshored and near-shored activities auditing much more feasible. For example, internal auditors today often have enhanced access to the senior managers who rely on their input to make smart strategic decisions. Whether that's the result of the higher visibility

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many audit shops enjoy in the wake of increased governance regulations or some other factor, auditors' newfound influence enables them to impact contracts with offshore and near-shore companies before they're written. That's key, internal audit experts stress. Also, use of targeted and more generally focused right-to-audit clauses in outsourcing contracts is on the rise, offering off-site internal audit departments access to the specific data and personnel they need to conduct their audits, even if the specifics of such access were not originally spelled out in the contracts in question. But despite these developments and the challenges of conducting assignments overseas, the nature of audit work has remained largely the same. Essentially, internal auditors turn data into information and advice. Changes in the national borders they have to cross and the kinds of contract language they have to comply with don't change that.

STRATEGIC PLACEMENT

There are differences in auditing offshored operations, notes Naohiro Mouri, managing director, Asia-Pacific auditor, in the Tokyo office of financial services firm JP Morgan. They include local regulatory concerns that can be substantially different from the home country, he says, as well as differing "communication styles and local labor and employment practices." He adds that a local governance structure that differs from the company's home country structure can have a significant influence on the local internal control construct. JP Morgan's response: "We have local internal audit teams in our offshored countries," Mouri says. "They work with the home-country auditors, who cover the processes that are connected to and impacted by the offshored processes." Moreover, he says, regional audit management and home-country audit management are involved in the company's planning, execution, and reporting processes.

Norman Marks, vice president, internal audit, at Business Objects SA — a US $1.5 billion global business intelligence software company with joint headquarters near Paris and in San Jose, Calif. — understands the new reality of what constitutes a domestic company and what doesn't because he lives it every day. In fact, more than 50 percent of the employees at his organization report to a manager in a different country. Business Objects has several outsource- and offshore-based relationships, including an offshored financial services center in Dublin, Ireland, and product development centers in Bangalore, India, and Shanghai, China.

"We develop and sell our business intelligence software all over the globe and have business offices in most major cities," Marks says. "Like many global companies, we have placed our internal auditors in strategic locations around the world, for a number of reasons. Cost is one factor, as is proximity to management and to where the audits will be performed." For example, he explains, one of his primary objectives is to locate staff near his customers in senior management, so regional leaders may be positioned at regional headquarters, such as the Paris or San Jose offices. But the balance of the staffing may be influenced by cost, with a disproportionate number, relative to where the work will be performed, in Asia.

To Marks, those considerations are simply a part of doing business in an increasingly global economy, and to him they represent an extension of what internal auditors have been doing all along. "Organizations do business globally, so what's so special about performing internal audit work globally?" he asks. "As a global company, you audit where the risks are." In fact, he adds, the challenges he faces as he audits offshored and near-shored operations internationally tend to be much like the kinds of challenges companies face when they simply open and then audit branch offices at home or abroad. *Outsourced* or *offshored* are contemporary terms of art in Marks' world; auditing a company's compliance and assessing its risk are timeless by comparison.

OFFSHORE RISKS

Jeff Perkins, a six-year veteran of offshore and near-shore auditing, is similarly immersed in the reality of global business today. As vice president, internal audit, at worldwide consumer credit firm TransUnion LLC in Chicago, he's involved in just about every type of corporate affiliation, across five different countries. Some of TransUnion's corporate ties to other firms, he reports, resemble those of domestic, owned operations; others run the gamut from near-shored but not owned operations to offshored but not owned and offshored and owned. TransUnion outsources typical back-office processes, he says, including its call center, its information technology (IT) help desk, and certain IT programming functions.

"The lines between owned overseas divisions and offshored and near-shored operations are getting blurred," Perkins says. "In fact, every now and then when I say to someone, 'You have to remember, you're a vendor,' that person will respond, 'No, we're a partner,' even though that's not the case." The contracted companies that handle offshored and near-shored operations don't share in the contracting company's revenue stream, brand reputation risk, or financial loss risk — except regarding what's in the contract. "In terms of oversight framework, organizational boundaries, and financial indemnity, the more processes an organization relies on from a third party, the more the lines will become blurred," Perkins comments.

A handful of issues differentiate auditing offshored and near-shored company activities from day-to-day, domestic-operations-only auditing, Perkins says, but they don't change much in nature as the world shrinks — they just become more common. One business risk he points to is the geographic distance; another is the political environment in an offshore land. There's also risk inherent in auditing activities that transpire under different countries' differing regulatory schemes and cultural backdrops. Moreover, Perkins adds, there may be risks associated with the legal environment in offsite locations. "If we try to prosecute someone offshore," he points out, "we have to respect the laws of the country where the fraud occurred, even if it's a domestic company."

At the same time, Perkins comments, there are new process technologies available — including developments in quality assurance and fraud monitoring controls developed internally by the audit department — that have been designed specifically for offshored operations. And internal auditors, he stresses, are increasingly comfortable making the kinds of judgment calls required to perform outsourced operations audits successfully. His team, for example, performs an informal "cultural assessment" of potential contractees' home regions and company posture, in addition to TransUnion's due diligence process, before contracts are signed. Often, facts and data surrounding a company's security or ethical posture are limited, he says. If only general business trends exist, the contracting company must rely on its own judgmental evaluations. Internal auditing, he continues, has long been a risk-based profession. "There are frameworks and methodologies that internal auditors employ that are consistent," he says, "but how those are employed varies considerably by company and by industry."

Flexibility, then, is key in auditing offshored and near-shored operations. "The biggest challenge is the time difference," Marks says. "I have people all over the world, so I often must conduct at least two staff meetings, for example." Language constitutes another challenge, he says, but it's an increasingly easy challenge to overcome because much of business throughout the world is conducted in English. And the notion of cultural differences isn't exclusive to international trade, he notes. It exists among, say, Connecticut, Texas, and California, too. "Those are simply things you work around," Marks says, noting that language assistance, for example, is generally easy to secure.

A SEAT AT THE TABLE

Internal auditors are responding to the changes around them with a variety of tactics: some tried and true, and others more recent in their common use. Many internal audit departments, in fact, now become involved in auditing offshored operations even before they're offshored in the first place. Sometimes that intervention alters the eventual contract terms or puts a stop to the entire deal. "There are many benefits to having internal auditing involved early in the process to review the draft contracts, performance

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metrics, and service level agreements, as well as the internal control and audit requirements," Perkins explains.

Setting the correct tone surrounding internal controls and performance expectations on the front end is less expensive than trying to revise existing practices later in the deal, of course, which is why smart companies seek internal auditing's input as early in the contracting process as possible. "Company management has placed a high degree of reliance on our internal audit department's opinions during the due diligence phase of several potential relationships," Perkins says. "Our input has prompted management to avoid working in certain countries or regions or with certain vendors." Also, he emphasizes, outcomes from ongoing audit work have contributed to the company's revising business decisions and strategies regarding offshored activities. The internal audit team works closely with other corporate functions, including legal, compliance, and security, he adds.

Internal audit departments have sought and earned a powerful place at the planning table at many firms, and they should endeavor to leverage that burgeoning influence to make sure that kind of information flow continues, explains Bethany Hetland, senior vice president, internal audit, at Allianz of America, a North America-based division of a German insurance, asset management, and banking company. "Internal auditing's strategic role provides more value than ever before," she says. "The audit function should be involved from the due diligence phase and forward to contracting and implementation offshore."

Internal audit departments can provide recommendations on how to craft the contract correctly from the start, Hetland points out. But they need to make sure their voices are heard. "There's a change in mentality involved, and certain individuals in certain organizations do not see internal auditing in that capacity yet," she says. "Some still see internal auditing as the cop." Leaders at her company seek input from internal auditing and risk management because they view those departments as business partners, she says. Allianz has outsourced some elements of its IT infrastructure to a company that divides the work among several international locations. "Because we outsourced them, we no longer truly own those processes — the vendor does," Hetland says. "From an internal audit perspective, we need to ensure that Allianz and the vendor are in compliance with the contract because we don't have that control."

Internal auditing's key role, Hetland continues, is making sure the executives involved in the contracting process are "fully aware of all the risks out there." Toward that end, her internal audit department reviews offshoring and near-shoring contracts to ensure they're based on a clear understanding of how the relationship will ultimately

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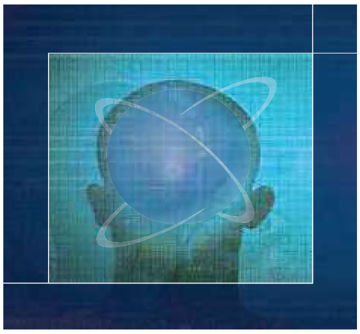
Offshoring Terminology

Hans Spoel, outgoing executive director of corporate audit services at telecommunications firm Alcatel-Lucent SA, Paris, notes that a problem with discussing internal auditing's role in offshoring and near-shoring lies in the consistency of the terminology itself. "There is not, really, a common international understanding of what exactly is meant by offshoring," he says, asking, "Where does offshoring end, and where does outsourcing start?"

In his view, offshoring involves moving work to parts of the world that are cost-advantageous, but that may pose significant risks in contract management, intellectual property protection, export controls, privacy and security, and tax structures. *Near-shoring*, he says, means moving work to parts of the world that are cost-advantageous and that pose far fewer, if any, of those risks. *Best-shoring* is moving work to a provider that will then decide where to place the work for the best contract performance. And *in-shoring* consists of setting up a shared services center in an offshore location to provide central process delivery for all of a company's business units.

Alcatel-Lucent, he notes, is involved in most of those scenarios. That reality, he says, has heightened internal auditing's role in highlighting the associated risks and leading efforts to mitigate those risks. The internal audit department does that, he adds, by remaining involved throughout the contracting process behind the offshoring — or near-shoring or best-shoring or in-shoring — arrangement, during project planning, implementation, and post-implementation reviews. The internal audit department's involvement at those various stages "ensures continuous improvement of the process and develops positive relationships with the business units and other groups involved," he says.



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work. "Contracting is the most critical piece," she says.

RIGHT TO AUDIT

Tony DeVincentis, deputy managing partner of internal audit services in the Jericho, N.Y., office of Deloitte & Touche LLP, says he spends a significant amount of time with clients on their relationships with outside parties, often focusing on cost savings or revenue recoveries that result from a focus on contract risk. He is a firm believer in making sure there's a "right-to-audit" clause in any contract with a vendor, partner, or customer, calling those clauses "critical." And internal auditors need to make sure those clauses are strong enough to allow them to perform their work adequately and form any necessary conclusions, he says, emphasizing that internal auditors should have the opportunity to offer that input as early in the process as possible. "Contracting is run by the legal department and the associated business unit," he comments. "But internal auditors need to have a seat at the table when those types of contractual agreements are created. They bring a different perspective than the other teams."

The American Institute of Certified Public Accountants' Statement of Auditing Standards (SAS) No. 70: Service Organizations is an increasingly relied-upon tool in offshoring and near-shoring arrangements, especially when used with a right-to-audit clause. If a company in the United States outsources to another large U.S. company with overseas operations, that company is likely to use SAS 70 as well. Moreover, global companies that are used to dealing with large companies also are very likely to have SAS 70s in place. "For a U.S. company, auditing a third-party outsourcing firm in another country that does not have an SAS 70 is comparable to auditing a third-party company in Tucson, Ariz., that doesn't have an SAS 70 — except that you have to travel," Marks says.

Hetland combines the SAS 70 and a right-to-audit clause. "When we contract with a vendor, we put a right-to-audit clause in the contract because the SAS 70 is not sufficient to cover everything, including comprehensive compliance with the U.S. Sarbanes-Oxley Act of 2002," she says. How difficult that is depends on the vendor; in many cases, securing inclusion of that clause can be a struggle, she adds. Her organization's sister company, Fireman's Fund, entered into an outsourcing relationship a year or so ago, she reports, and that vendor can further outsource — but Fireman's Fund's right to audit does not extend to those secondarily contracted firms. "We've tried to enhance the contract language to make it clear that if it's our business in some way, shape, or form, we have to have the right to audit," she says.

A UNIVERSAL LANGUAGE

Despite contractual and other challenges, experts agree that practitioners tasked with auditing increasingly complex and overlapping offshoring and near-shoring relationships worldwide can probably handle just about any situation that comes their way. Attorneys, accountants, and other professionals have country-specific standards, Perkins says, but "certified internal auditor" is a worldwide designation. "Internal auditors speak a universal language," he says. "We may have slightly different control frameworks, but we should all follow the same professional guidance, ethics, and standards provided by The IIA."

Indeed, Marks notes, the processes for auditing field offices' operations and for auditing offshored or near-shored operations should be identical, except for the cost of travel. "Many of the same challenges exist," he says. Internal auditors need to audit at the speed of business, he adds, and where the business risk resides. "What's important, from an internal audit perspective isn't an organization's address. Is GM an American company? Is Toyota a Japanese company?" he asks. "The better questions are, 'Where does it do business?' 'Where does it do its manufacturing?' and 'Where are its people?'"

Hans Spoel, outgoing executive director of corporate audit services at telecommunications firm Alcatel-Lucent SA, Paris, agrees. "Alcatel-Lucent is a global organization in the business sense," he states. "We really don't have the notion of 'home country' anymore. Our business is spread over some 130 countries worldwide." And his company's audit department mirrors the organization itself, he stresses, with staffers located all over the world who are, if not physically, certainly organizationally and methodologically still part of one centralized service. What they do, therefore, is largely consistent nation to nation, no matter what kind of contract links the companies being audited. The past is the present, performance-wise, despite the rapidly evolving lexicon of border-ignorant corporate affiliations. The more things change, as they say, the more they stay the same.

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