

THE NASCENT CHIEF AUDIT EXECUTIVE:

Preparing for a Brave New World of Business

by Charles B. Eldridge & Paula Park

The growing complexity of managing an organization today, combined with enormous pressure to produce bottom line results, has created a challenging business environment fraught with risks and responsibilities. Managing internal data and ensuring that financial information is accurate and up-to-date is paramount — particularly in an era of corporate scandals and growing government regulation.

Although internal auditing has been a part of the corporate scene since the 1940s, it is now garnering greater attention than at any time in history. Sarbanes-Oxley, Basel II, the Health Insurance Portability and Accountability Act (HIPAA) and other regulatory initiatives raise the stakes on the accuracy and availability of internal data. It is no longer acceptable to manage information in a casual way. In fact, it is downright dangerous to operate without strict internal controls.

According to the 2004 Korn/Ferry International Board of Directors Survey, audit-related issues are achieving greater prominence in the boardrooms of the world's largest organizations.

The average implementation cost in the U.S. for Sarbanes-Oxley stands at \$5.1 million. Moreover, the percentage of respondents at American firms declining board invitations due to increased liability has more than doubled since Sarbanes-Oxley became law, from 13 percent in 2002 to 29 percent in 2004. Past Korn/Ferry studies have revealed that organizations handle audit functions in markedly different ways and use significantly different structures.

Amid this rapidly evolving audit environment, the role of the chief audit executive (CAE) is undergoing fundamental change. It is a position that requires a deep understanding of wildly diverse enterprise factors, including strategic business issues; the inner workings of information technology, including security, access control and business continuity; and an understanding of fundamental change management issues. As Robert Hirth, managing director at Protiviti, puts it, "It is a high visibility and high value position."

In a post-Sarbanes-Oxley environment, today's CAE must assume a higher profile than at any time in the past. This means spending more time with the audit committee, possessing strong leadership skills, and serving as a strategic thinker and beacon of clarity and integrity. According to Dan Langer,

global director for Internal Audit Services at Jefferson Wells, "the absolute key to success is knowing how to bring the big issues to the table. It takes a unique combination of skills to really be effective."

Not surprisingly, these heightened requirements necessitate the CAE to possess specific personality attributes in order to succeed. This individual must provide strong leadership; offer exceptional technical skills; have an excellent grasp of risks and controls; link the strategy and objectives of the organization to human resources and staffing policies and actions; and interact with others in a positive way. Most important of all, this person must possess unquestionable ethics and integrity.

What's more, a high level of certification is essential. Practicing internal auditors who hold the Certified Internal Auditor (CIA) designation must complete and report 80 Continuing Professional Education (CPE) hours every two years. The Institute of Internal Auditors (IIA) oversees these certifications; candidates must pass a comprehensive examination and also meet educational, experience and character requirements. In addition, many internal auditors are CPAs who take at least 80 related CPE units per two-year period to maintain public accountancy certification. In the past, it was possible for organizations to rotate non-audit executives through the CAE position; now, many are reevaluating this approach due to the high level of specialized knowledge required.

Organizations lacking a cohesive auditing structure and a highly qualified CAE are increasingly at risk. Nevertheless, finding the right person for the job and designing internal processes that maximize results can prove daunting. On the front lines of business, the bottom line is that internal audit is too important to ignore, and building the right foundation and structure is vital to the organization. In the end, success comes to those who approach audit strategically and decisively.

The Changing Face of **INTERNAL AUDIT**

There is no question that a well-designed internal audit process can provide enormous benefits to organizations of all sizes and across various industries. Finding the right CAE is a key piece of the puzzle and can determine whether an organization meets internal standards and outside regulatory controls or faces ongoing chaos and problems.

In the past, it was often enough to manage internal audit in a fairly straightforward and unfettered manner. Today, the responsibilities and requirements

for effective auditing are forcing many enterprises to examine the issue more closely. Korn/Ferry found that 32 percent of companies surveyed will hire internal audit staff during the next year (replacements or additions) and 31 percent will "upgrade" the current staff. In many cases, finding an effective CAE is a top priority.

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The stakes are high. At Wells Fargo Bank, Executive Vice President and Chief Auditor Kevin McCabe says that corporate executives and members of the audit committee spend considerably more time poring over issues related to Sarbanes-Oxley and other regulatory initiatives: "The time spent with board members is much greater than ever before. People throughout the company are reading reports and audit-related documents more closely and carefully."

The situation is not likely to change in the months ahead. In addition to the average of \$5.1 million required to implement Sarbanes-Oxley, organizations surveyed by Korn/Ferry in 2004 indicated that ongoing compliance will trim an average of \$3.7 million in total from the corporate bottom line. It is not difficult to understand why. In addition to an extensive list of compliance requirements, an organization must revamp business processes and IT systems. At the same time, internal auditors must obtain training and numerous certifications.

Within many organizations, the CAE must oversee hundreds of controls. Documenting, improving and testing these controls is essential, as is keeping an eye on all the processes that link to the controls. Changes in the regulatory environment and in reporting have significantly increased an organization's exposure and risk. The CAE must provide the foundation for compliance.

An additional factor that makes the task more challenging is the fact that over the last two decades, the profile of the CAE has changed. For years, companies relied on individuals with a heavy accounting background. However, during the 1980s and 1990s, many organizations turned to individuals with MBAs and others with minimal expertise and little experience in internal audit. Now the pendulum is swinging back in the direction of those with a heavy dose of audit experience. Yet finding candidates with the right balance of knowledge, skills and experience can be extremely difficult.

In addition to technical knowledge and auditing skills, the successful CAE must provide the leadership and boardroom presence needed to guide an organization through the complex world of compliance issues. "Teaming in the boardroom has never been more important. The audit officers out there leading the pack are those that can keep an eye on the big picture, relate to a diverse array of constituencies, foster a true teaming environment and have the fortitude to ensure everyone understands the

implications and ramifications of alternative decisions," according to John Hickox, an Atlanta-based partner in the Risk Advisory Services practice at KPMG.



A NEW LEADERSHIP *Agenda*

In any profession, it is essential to find the right person for the right position. Yet, when it comes to auditing, the issue is magnified. Failure to comply with Sarbanes-Oxley and other regulatory requirements can result in criminal and civil penalties and fines. Moreover, the lack of airtight audit procedures can lead to a decline in confidence on the part of investors and the public. That, in turn, can result in lagging performance and profits. Managing a company's reputation is essential.

The CAE is the focal point for achieving compliance success. Finding someone with the qualifications and personal qualities required to perform at the highest level is essential. In addition to technical knowledge and expertise, the CAE is a position that requires an enormous amount of time, patience and a heightened sense of responsibility.

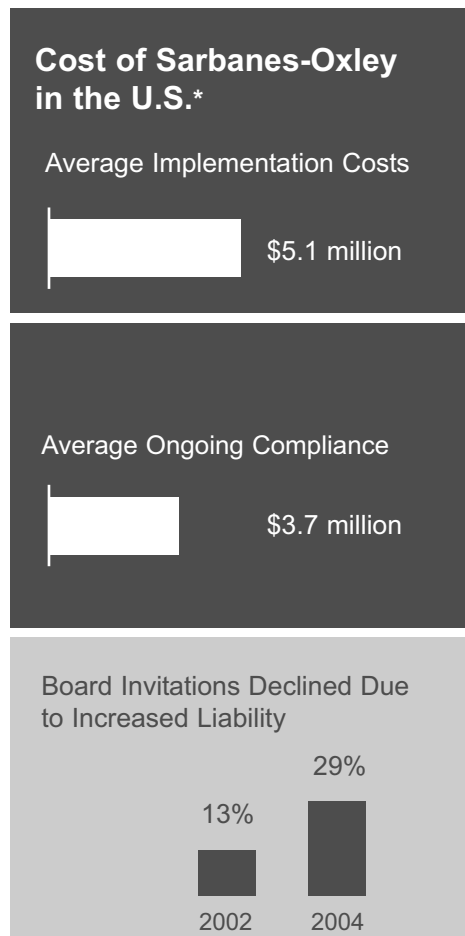
One of the keys to success is the ability to think strategically. The CAE must understand the strategic and philosophical issues that drive the business forward, while working closely with the CEO, CFO and other senior executives. It is also essential to understand the challenges that the audit committee faces and develop a plan for turning regulations and initiatives into reality.

For example, Wells Fargo's McCabe makes it a point to understand new regulations and provisions as the organization rolls them out to various leaders within the organization. He knows what is needed to achieve maximum results. He also spends time preparing audit team members and working to coordinate business processes and paperwork to ensure that there is excellent coordination and communication. According to McCabe, "too much control at the local level can lead to a high level of ownership but a lack of consistency, while too little control makes ownership a challenge but improves consistency."

It is also necessary for the CAE to understand the various risks an organization faces and introduce practical ways to deal with them. McCabe comments, "It is important to take a balanced approach but understand which risks are the greatest and make sure that they receive the most attention." In many instances, a CAE must also referee disagreements and conflicts among different constituencies. The CEO, CFO, General Counsel and others might have consider-

ably different views about how to structure audit processes and how to deal with various situations.

Strong leadership is indeed a hallmark of a successful CAE. It is essential to accept direction, provide guidance, develop the skills and expertise of the auditing team, and spend a great deal of time





and energy planning, developing and linking the strategy and objectives of the company to the work that internal audit actually performs. Success requires a delicate balance between collegiality and forcefulness, technical expertise and people skills.

Stan Martin, general auditor for Freddie Mac, views the CAE as someone who can discuss concepts and broad topics with senior executives but who also understands the details and can translate concepts into actions. Unlike a CFO, who is typically involved in managing business processes and technology and looking outward to the investment community, the CAE serves primarily as an advisor. Sessions with the CEO or board often resemble fireside chats. "This person cannot implement change...but by informed discussions can recommend it," he says.

Bob O'Neill, general auditor at Fidelity Investments, believes that a successful CAE approaches the position with "eyes wide open." He says that it is essential to approach the audit process as a business strategist and not an auditor. This means straying from the audit plan, if necessary, and constantly looking for holes and potential hang-ups. "Creativity, discipline and courage are all essential ingredients," he says.

Yet the need for technical knowledge cannot be understated. Carl Waller, managing director of consulting firm Protiviti, believes that there is an ongoing movement to a broader, all-encompassing internal audit, risk and compliance approach. "A CAE must possess outstanding operating and financial acumen, as well as a deep understanding of market risks and general business risks."

Twelve Traits of a Successful CHIEF AUDIT EXECUTIVE

- 1▶ Viewed by others within the organization as a strategic business partner
- 2▶ Serves as an active contributor to the thinking that drives the business
- 3▶ Has the vision to originate ideas and empowers others to do the same
- 4▶ Possesses the business acumen to advise and recommend executable strategic moves
- 5▶ Constantly alert to best practices and trends and communicates the information to the business leadership
- 6▶ Counsels, advises and imparts insights and views that others often overlook
- 7▶ Offers engaging, artful communication that inspires others to listen, absorb knowledge and constructively spar

In order to succeed, a CAE must put all the pieces of the audit puzzle together and map out a strategy that an enterprise can use to achieve maximum results. Simply put, it is a unique position that carries enormous responsibilities. Finding the right person is no longer a luxury, it is an absolute necessity.

- 8▶ Provides powerful leadership qualities that others immediately recognize and act on
- 9▶ Distills huge volumes of information into insights that lead to the improvement of the business
- 10▶ Has an insatiable appetite for constant and continuous business improvement
- 11▶ Possesses unquestionable and unflinching ethical values
- 12▶ Maintains a commitment to ongoing training and learning in order to stay current with industry and regulatory trends

Managing the Convergence of

AUDIT, RISK AND COMPLIANCE

Today, audit, risk and compliance are inextricably intertwined. Although various departments and outside service providers might handle the myriad functions that fall under these categories, an organization must develop a cohesive strategy and maintain a laser-sharp focus on achieving results. The CAE plays a major role in transforming this goal into reality.

The convergence of audit, risk and compliance is taking place as a result of increasingly complex business practices, information technology and growing pressure to conform to post-Sarbanes-Oxley regulatory pressures. In the past, the tools and capabilities did not exist to merge these three distinct areas. However, that is no longer the case. Sophisticated software and more advanced business processes are transforming these tasks and making a centrally managed approach a necessity.

While a number of professionals have handled these various tasks in the past — including audit executives, CFOs, security analysts, operations executives and outside auditors — this too often leads to a fractured approach. That, in turn,

contributes to valuable information and potential problems falling through the cracks. On the other hand, by installing a CAE, it is possible to address the challenges holistically.

Quite often, the CAE reports to the Chair of the Audit Committee, with administrative support from the CFO. Although many CAEs prefer a reporting relationship to the CEO, in actual practice, it is happening only in rare cases. This individual might also interface with external auditors responsible for attesting to the accuracy of accounting reports and other documents issued to outside investors and other groups. According to Protiviti's Hirth, the dynamic nature of the task ultimately means that the CAE "reports to a level within the organization that allows the internal audit activity to accomplish its responsibilities."

Finding an appropriate candidate to handle the duties of the CAE is no simple task. In many cases,

audit department executives and external auditors do not have a broad enough focus to handle the challenges of chief auditor with a high level of proficiency. Those equipped to tackle the CAE position typically gain experience in a variety of financial, business and auditing tasks. Those looking to develop CAE talent internally can benefit

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by rotating promising audit executives among a variety of positions and posts.

Hirth believes that the role of the CAE will become far more important in the months and years ahead. Those who hold this position will be asked by corporate boards and C-level executives to participate in high-level strategic meetings and help guide the decision making process. The end result is an executive who addresses audit, risk and compliance issues to help guide the direction of the organization.

The **CHALLENGE & OPPORTUNITY**

When the role of the CAE centers on overseeing and managing all the various groups and constituencies within an organization, it is finally possible for auditing to reach a more strategic level. Today's CAE must draw upon broad experience and a high level of expertise, but also understand the softer, people side of the business. As Sarbanes-Oxley and other regulatory issues move to the forefront, it is imperative that organizations expand their commitment to auditing in order to ensure bullet-proof results.

In today's business environment, where corporate decision makers find themselves constantly reacting to regulatory officials, shareholders and activists, the need to fully understand business processes, risks and controls has moved to center stage. The CAE has emerged as a key to developing solid management practices and the trend only promises to grow in the years ahead.

An outstanding CAE can provide vision and ensure that an organization demands ethics, compliance and integrity.



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