

Internal Audit and Approach to Auditing



Presentation to Society of Actuaries

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Agenda

Introduction

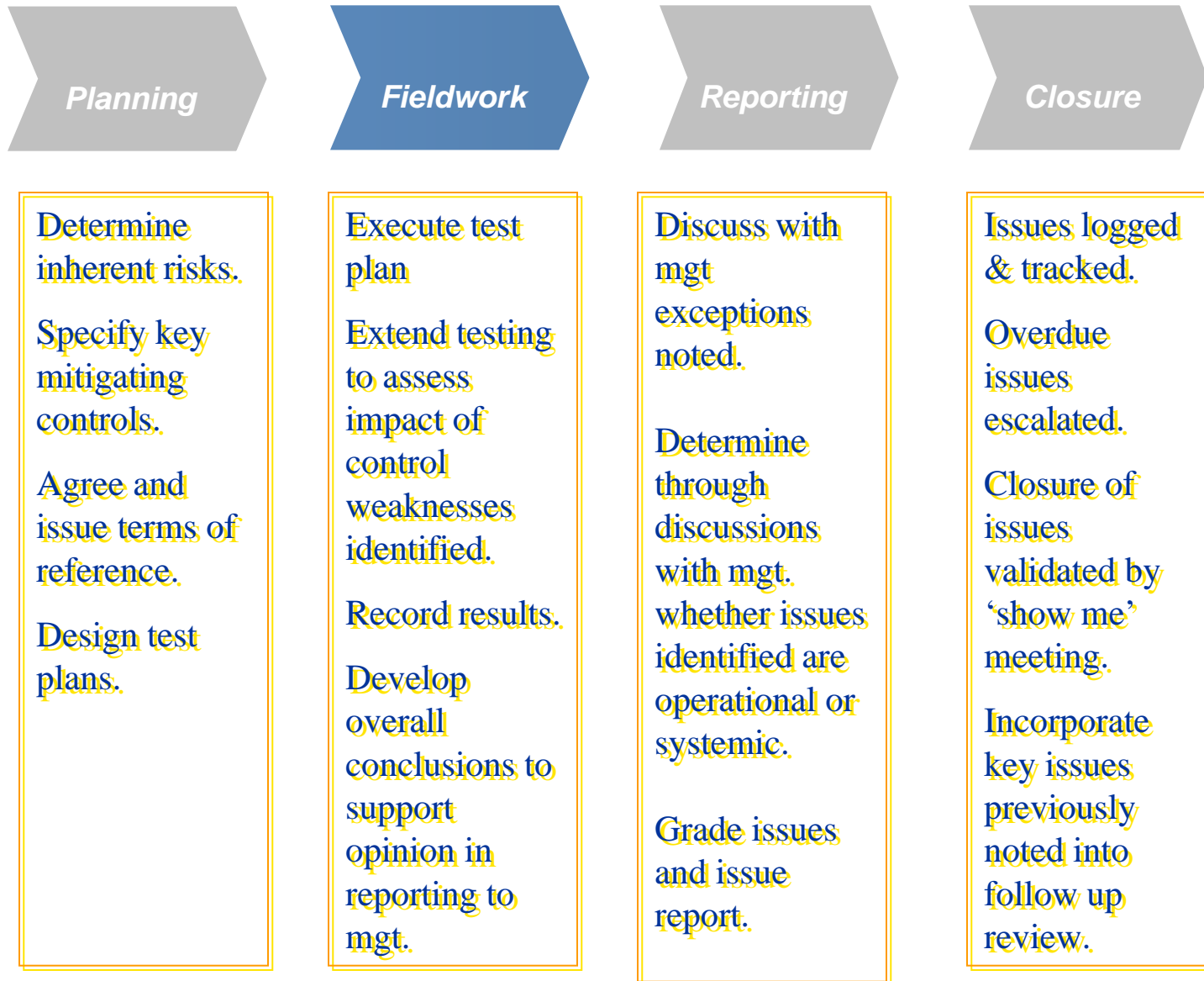
The Internal Audit Process - Overview

Internal Audit Fieldwork -Controls Testing

Test of Detail and selecting sample sizes

Challenges facing the Internal Auditor

The Internal Audit Process - Overview



Internal Audit Fieldwork – Controls Testing

In designing an appropriate test for each key control, as well as assessing the type of testing to be performed the following should be considered:

- Size of the risk
- Contribution of other controls
- Performance characteristics of the control
- Testing the whole control
- Sample sizes and selection
- Control operation and sustainability

Controls Testing – ‘Typical’ sample sizes as applied by Internal Audit

Nature of Control and Frequency of Performance	Tests of Controls - Minimum Number of items to Test
Manual control, performed many times per day	25
Manual control, performed daily	25
Manual control, performed weekly	5
Manual control, performed monthly	2
Manual control, performed quarterly	2
Manual control, performed annually	Test annually
System Application control	Test one application of each application control for each type of transaction if supported by effective IT general controls (that have been tested); otherwise test 25
IT general controls	Follow guidance above for manual and automated aspects of IT general controls

Test of detail – Types

Some form of 'Test of detail' should be performed when one cannot obtain full assurance over the effectiveness of the control environment. Typically test of detail could be performed by a member of the Compliance and / or Quality Assurance Team in conjunction with a technical expert. There are three types of test of detail:

- **Target testing** – involves selecting items to be tested based on some specific characteristic (e.g. represents a material risk). The items chosen to be tested are normally stratified based on higher value or higher risk rather than selecting them randomly. One should also consider whether the untested balance is material. If it is, consider the results of the previous test of control and / or target test to ascertain the need for more assurance on the untested amount.
- **Attribute testing** – used when one is concerned with the acceptance or rejection of a hypothesis. It is used to reach a yes or no answer to a question.
- **Non - statistical sampling** – involves randomly testing less than 100% of a population and utilising results to draw conclusion about the entire population. Sometimes saves time and expense that may be involved in 100% comprehensive testing.

Selecting and documenting approach to test of detail – Guidelines

Step 1 – Determine test objective

Step 2 – Identify population to be tested

Step 3 – Determine the level of comfort required

1. High
2. Medium
3. Low

Step 4 – determine level of accuracy required

- high or low

Step 5 – select sample by considering relationship between desired level of comfort and sample size.

Step 6 – Evaluation of result

- Interpret results and extend testing where appropriate
- Extrapolate results on whole population ($\text{€Deviations} / \text{€total sample} \times \text{€population}$)
- Reach overall conclusion.

Illustrative guide to non - statistical sample testing (for sample sizes over 200)

Note – for best results, random select items from population

Level of Comfort	Level of accuracy		
	> 10%	5% - 10%	< 5%
Low	15	25	30
Medium	30	50	60
High	60	100	120

Challenges facing the Internal Auditor

- Setting the Scene!
 - What research is telling us
 - What stakeholders are telling us.
- Outlook for Internal Audit – Integrated Assurance ?
- Issues noted in the last year – 'The top three'

What the research is telling us !

.....from score keeping to strategic partnering....

“Global Companies are looking to risk and control management to become more strategic and forward looking with a focus on creating as opposed to merely preserving value.

These Companies will be looking for a genuinely holistic, integrated, future focused and process orientated approach to risk and control.”

Economist Intelligence Unit and KPMG

The Evolution of Risk and Controls, October 2007

Challenges to IA from stakeholders and the business?

Why is IA covering the same ground as operation risk / SOX / other functions?

You need to set a clear bar for what internal control excellence should look like and communicate it!

What could bite us? How can we anticipate and prevent the next control failure?

Going forward, how does the business fully identify potential control failures?

How do we take out costs whilst maintaining control?

You should be focused on whether complexity in our processes is driving higher levels of risk!

Integrated assurance – the future?

The Challenge

How does IA evolve to provide a 'real time' overarching view of the control environment rather than just focusing on individual areas of the business?

What are the current IA challenges?

- What governance model is needed to avoid a Northern Rock
- Avoid the contradictory views given to executive management
- Avoid the 'nuisance factor' and inefficiency of duplication of work by different assurance functions

What does "good" look like in the future?

- Internal audit gather and integrate assurances provided by others
- IA, Op Risk, SOX and other functions:
 - Share a risk profile
 - Use same technology (risks, issues etc)
 - Rely on others' work, where appropriate
- Streamline duplicated activities
- The business is given a single view of risk
- Providing interpretation rather than information
- IA and the business provide an opinion on the control environment

Action Needed

- Produce audit reports that provide comprehensive, value based assurance rather than information by function or risk area
- Help management identify themes, trends and business challenges
- Conclude on the effectiveness of the control environment

Issues noted in last year – ‘The top three’

Addressing the Compliance Burden – More Quality Assurance!

Responsibility & Ownership

The Human Factor

Final thought !

“Corporate scandals of recent years have clearly shown that the plethora of laws of the past century have not eliminated the less savoury side of human behaviour. Rules cannot substitute for character.”

Alan Greenspan,

***US Federal Reserve Chairman
Chicago Tribune, April 17, 2004***



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