

Performing Cross Border Internal Audits

Steve Newstead – Baker Tilly RubinBrown
David Gwilliam – Baker Tilly



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Agenda

- Introductions
- Performing Global Risk Assessments in today's business environment
- The impact of international corporate governance rules
- Developing a uniform approach
- The practicalities



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David Gwilliam – C.A. - Scotland



•Scotland?



•Invented Whisky



•Invented Golf

•Invented Television

•Invented Internal Combustion Engine



•Invented Modern Road Surfaces



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David Gwilliam - Scotland

So:

When you come off the golf course, jump in
your car and drive home to sit in front of
your T.V. to watch the game with a
glass of scotch –

Remember who made it all possible!



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Steve Newstead – C.P.A. St. Louis, MO

St. Louis' claims to fame:



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Getting to know you...

- Our Audience: CFO/Controller, CAE, Service Provider?
- Companies with an Internal Audit Department?
- Are you performing international internal audits?
- Are you doing risk assessments?
- Are you doing GLOBAL risk assessments?



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Thinking about Global Risk Assessment....

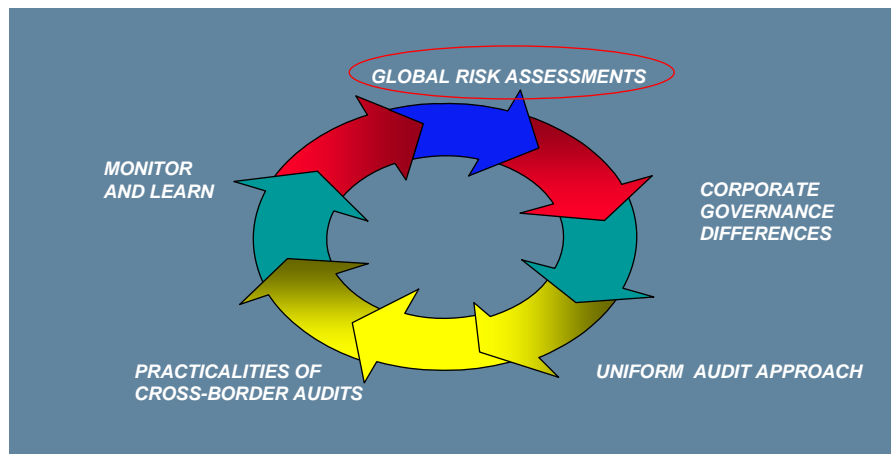
What are your top three to five organizational risks?

- 1.
- 2.
- 3.



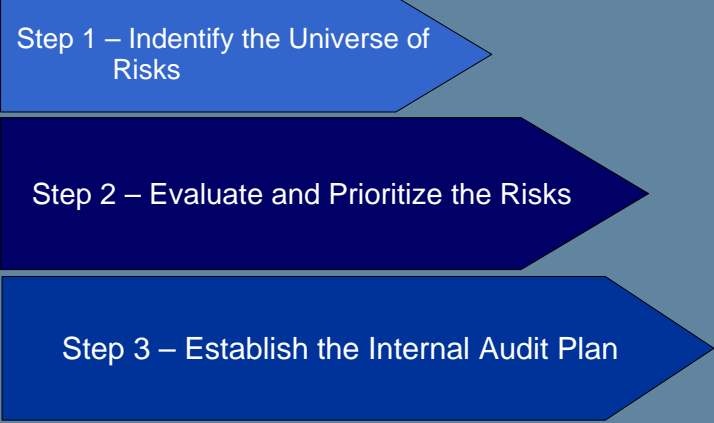
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Performing Global Risk Assessments

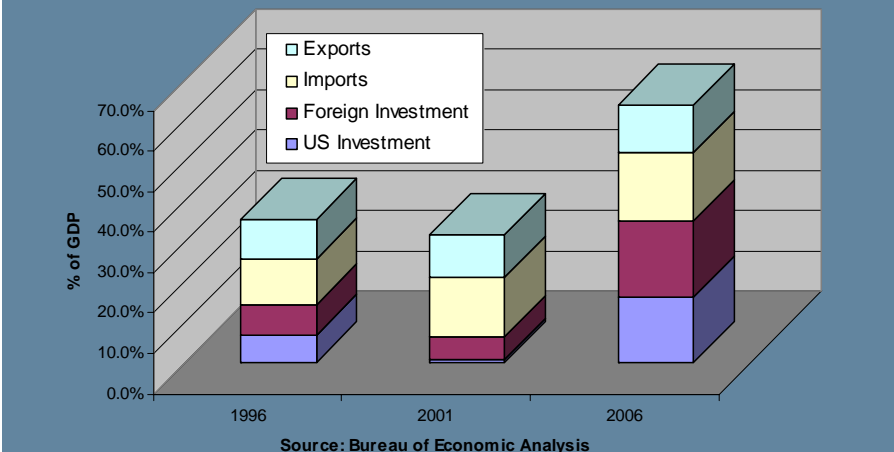


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Performing Global Risk Assessments



U.S. International Economic Activity



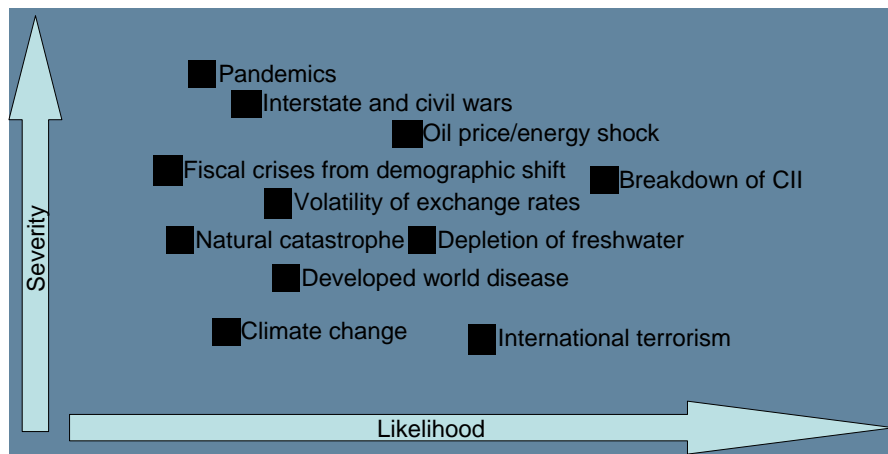
Global Risk Assessments

- Traditional components of a risk assessment:
 - Financial risks
 - Operational risks
 - Regulatory risks
 - Competitive risks
 - Currency risks
- External risks affect businesses more than ever before. So, in addition, new risks must now be considered:
 - Civil unrest
 - Climate change
 - Terrorism or pandemics
- Both a top-down (global perspective) and bottom-up (regional or country specific perspective) approach should be used



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Core Global Risks in the 2000's

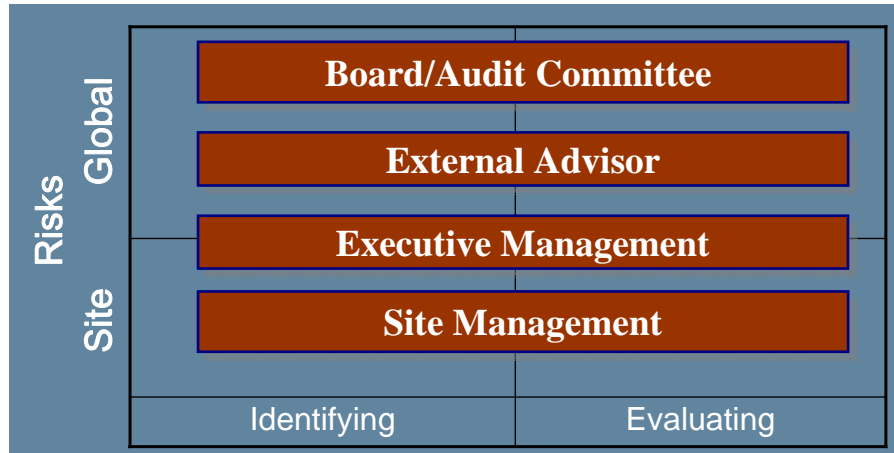


Source: World Economic Forum, Global Risks 2007



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Identifying and Evaluating Risks



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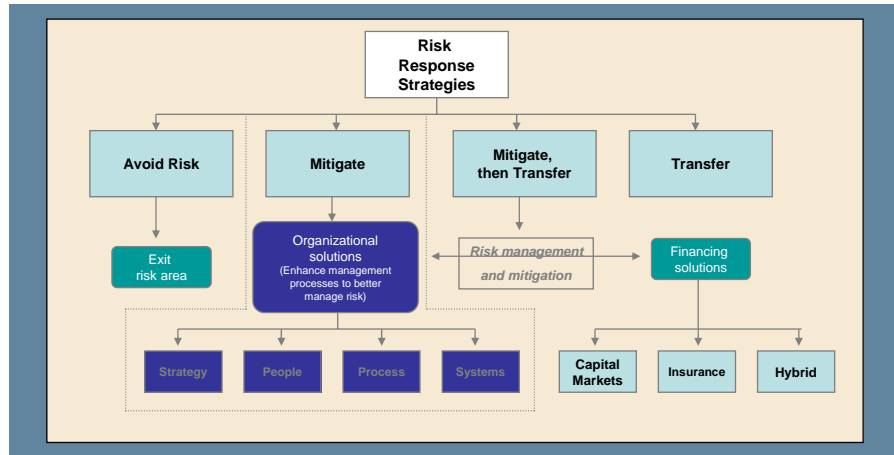
Sources of Risk Information

- Surveys
- Interviews/Focus groups
- Internal data
- Benchmarking/Peer analysis
- External Research



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Responding to risks



Prioritization of Identified Risks Internal Audit Plan

	2008	2009	2010
HIGH	<ul style="list-style-type: none"> Supply Chain Management (Logistics) IT General Controls Review Quality Control and Procedures Business Continuity IT System Review – AS400 	<ul style="list-style-type: none"> Foreign Corrupt Practices Fraud Prevention Analysis (includes segregation of duties) Shipping and Revenue Recognition Physical Inventory and Cycle Count Procedures 	<ul style="list-style-type: none"> Treasury Operations and Foreign Exchange Controls Human Resources – Labor Compliance Construction in Process Tax Accounting and Reporting IT System Review
MEDIUM	<ul style="list-style-type: none"> US GAAP Reporting (Transfer Pricing) 	<ul style="list-style-type: none"> Pricing Policies and Procedures 	<ul style="list-style-type: none"> Customs and Duties Fees
LOW	<ul style="list-style-type: none"> Receiving and Shipping 	<ul style="list-style-type: none"> Cash Disbursements 	<ul style="list-style-type: none"> Price Table Maintenance



Strategies for Mitigating Global Risk

Improving Awareness	Moving risks from the unknown to the known
Enhancing Communication	Allowing information to flow effectively between decision-makers and those experiencing the risk first-hand
Align Incentives	Creating the incentive frameworks that will allow decisions to be made to reduce risks
Investing in Infrastructure	Providing the investments necessary to mitigate risk
Institutionalizing	Creating, improving, and integrating the framework needed to mitigate risks into the corporate culture



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Obstacles to Global Risk Mitigation

- It is too costly to mitigate
- Taking action will just slow me down
- Too large to manage, and success is not guaranteed
- It could never happen to my company!

But...

Your Company is at risk!



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Corporate Governance Differences



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Corporate Governance – United States

- Value-creation for the shareholder is top priority
- Income statement focused
- Precise and restrictive legal framework (Sarbanes-Oxley law)
- Shareholder structure includes small shareholders and institutions



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Corporate Governance – Europe

- Harmonization of corporate governance regulations in European Union
- Balance sheet focused
- Shareholder and stakeholders interests
- Result from recommendations and good professional practices
- Shareholder structure family shareholding, banks
- Two-tier board structure
 - Management board which actually runs the firm
 - Supervisory board with outside directors only



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Corporate Governance – Latin America

- Spared from a generalized wave of corporate scandals
- Low levels of participation by individuals and institutional investors
- Insufficient legal shareholder protections and poor enforcement
- Inadequacies of the legal institutions in Latin America
 - Generate high levels of ownership concentration
 - Poor access to external equity financing



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Corporate Governance – Asia

- Introduced new rules and regulations in the wake of the 1997 Asian financial crisis
- Reforms are not being enforced
- Singapore and Hong Kong rank highest in the quality of their corporate governance practices
- China and Indonesia perform relatively poorly



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Corporate Governance – Asia

	Stakeholder focus	Single-tier board	Two-tier board	Size of code			Scope of Code	
				Small	Medium	Large	Limited	Comprehensive
China	✓	×	✓	×	×	×	×	×
Hong Kong	×	✓	×	✓	×	×	✓	×
India	×	✓	×	×	×	✓	×	✓
Indonesia	✓	×	✓	×	✓	×	×	✓
Korea	✓	✓	×	×	×	✓	×	✓
Japan	✓	×	✓	×	✓	×	×	✓
Malaysia	Note 1	✓	×	×	✓	×	×	✓
Philippines	×	✓	×	×	×	×	×	×
Singapore	Note 2	✓	×	✓	×	×	✓	Note 3
Taiwan	×	×	✓	×	×	×	×	×
Thailand	✓	✓	×	×	×	✓	×	✓

Notes:

1. Malaysia recognizes the importance of stakeholders, but argues that boards can only be made accountable to shareholders.
2. Singapore has a stakeholder concept (ie, corporations play a social role), but it protects workers through legislation.
3. Singapore's current code focuses solely on audit committees, but it is working on a more comprehensive code.

Source: Asian Corporate Governance Association

Source: Building Value in Asia: Corporate Governance and Compliance for a New Era

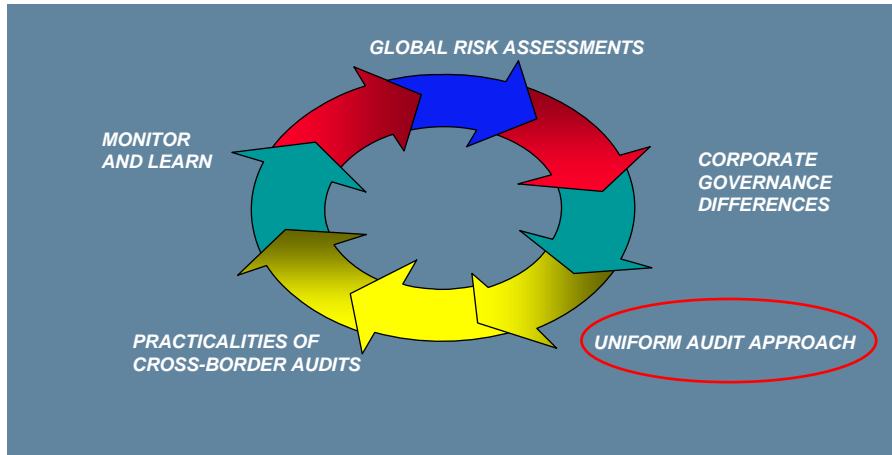


Future of Corporate Governance

Differences	Legal systems, shareholding structures, corporate cultures
Uniting factors	Multinational corporations, regulators, legal, audit and finance professionals, international investors
Convergence	Accounting standards (IFRS), stock-market law, financial information (Reuters, Financial Times...)

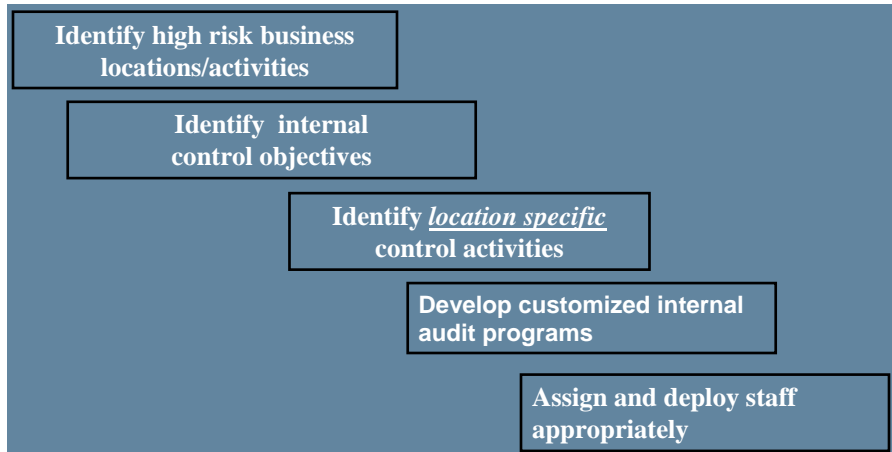


Performing Cross-border Internal Audits



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Uniform Audit Approach



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Uniform Audit Approach Revenue Recognition

Internal Control Objective	US Control Activity	International Control Activity	Audit Approach
Revenue is recognized at the time that title transfers from the seller to the buyer.	Most terms are FOB – Dock with revenue recognized upon shipment	13 Incoterms in effect with revenue recognized at different points in the production and delivery process	Both US and Internationally – shipment terms for each invoice should be reviewed to determine time of title transfer.



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Uniform Audit Approach 'Tone at the Top'

Internal Control Objective	US Control Activity	International Control Activity	Audit Approach
All employees are aware of acceptable behavior in dealing with employees, vendors, customers, etc.	Employees read Code of Conduct and sign indicating understanding. Whistleblower hotline is posted.	Code of conduct is distributed but some employees have option to sign. Whistleblower activity often discouraged.	US – ensure employees sign indicating understanding of code of conduct. International – Location specific testing to ensure ethical behavior.



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Uniform Audit Approach Purchasing Cycle

Internal Control Objective	US Control Activity	International Control Activity	Audit Approach
Purchases are authorized in accordance with delegation of authority.	Purchase orders signed by vendor predominant form of commitment.	Purchase orders prepared but not signed. Contracts used as signed commitment document.	US – ensure signed purchase order is in place for all purchases. EU/Latin America – ensure signed contract is in place for all purchases.



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Staffing International Engagements

- Assigning the "wrong" employee on international projects can be disastrous (and costly) to all parties involved.
- Common mistake employers make in recruiting for an international assignment is to base the choice solely on technical skills
- Make sure the project is adequately supervised



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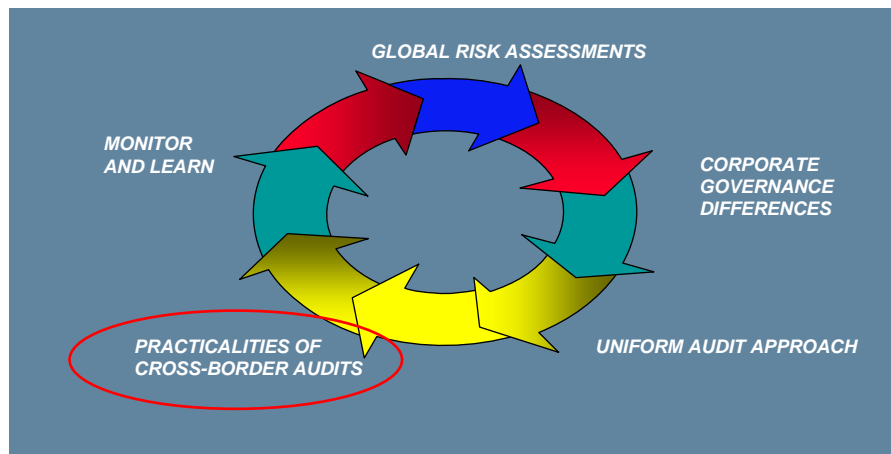
Benefits of Uniform Audit Approach

- Internal control objectives center on identified high risk areas
- Promotes efficient and effective use of audit resources
 - Reduces duplication of audit work
 - Introduces process simplification
- Simultaneously test internal controls over financial reporting, compliance, and governance – some controls will address more than one objective



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Performing Cross-border Internal Audits



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The Practicalities

- Accounting/auditing
- Language
- Culture/custom
- Legal
- Financial
- Technological



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Accounting / Auditing

- External audit
 - Substantive v's analytical
 - Paper v's IT
- Accounting Policy
 - US GAAP v's everyone else!
 - Principles v's rules
- Legal requirements v's voluntary disclosure



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Language

- US v's UK – two countries divided by a common language
 - Stock = shares
 - Stock = inventory
- English v's Other European
 - Reading is not comprehension
 - Translation – open to interpretation
 - Some countries e.g. Netherlands = very good English
 - Others e.g. Portugal – less so
- English v's Asian
 - Not just different words
 - Different character
 - Different syntax!



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Culture/Customs

- Working practices
 - Hierarchy
 - Sex equality
 - Working hours
 - Local holidays
 - Social customs
- Legalities
 - What is perfectly normal in US/UK can be illegal elsewhere!
- Professional differences
 - Auditors separate from other staff etc



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Legal

- Sales contracts
 - Legal v's indicative
 - Dispute resolution
- Employment law
 - Hiring & firing
 - Employee rights
- Corporate law (including audit regulations etc.)
 - Law v's practice
- Bribes/fees



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Financial

- Engagement terms
- Hourly rates v's daily v's fixed fee
- Rate differentials/blended rates
- UK (and much of Europe)– much higher than US in general
- Cost Plus v's Selling Price Minus



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Technological

- Not so varied these days – the power of Microsoft!
- However, many still ‘paper based’ - especially Eastern Europe etc.
- Beware US mobile/cell phones and blackberry - many don’t work in Europe without adaptor!



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Practical Tips – US → Elsewhere

- If Western Europe – UK good conduit
- If Asia – Hong Kong/Singapore
- If Eastern Europe – Poland (Hungary & Czechoslovakia)
= best chance of English being understood
- If Middle East – say you’re Canadian!



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Practical Tips – Elsewhere → US

- Working hours
- Shortened timescales/timetables
- Service culture
- Commercial culture



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The impact of International Corporate Governance Rules

- Wide and varied topic
- Impact of Sarbanes Oxley
- Other rules based e.g. Japan, Korea
- Other principles based – UK
- Regulatory authorities – European Union
- Sector specific – Basel II



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Questions and Discussion

Steve Newstead
Baker Tilly RubinBrown
One North Brentwood
St. Louis, MO 63105
steve.newstead@rubinbrown.com

David Gwilliam
Baker Tilly
23 Queen Street
Edinburgh EH2 1JX
United Kingdom
david.gwilliam@bakertilly.co.uk

