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Readings

Changing Internal Audit Practices in the New Paradigm: The Sarbanes-Oxley Environment



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Do the measures internal auditors are taking to help organizations comply with the U.S. Sarbanes-Oxley Act of 2002 represent a new paradigm or a regression to old practices? From the front lines of some of the world's most well-known companies and their internal audit departments, *Changing Internal Audit Practices in the New Paradigm: The Sarbanes-Oxley Environment* is dedicated largely to examining in the broadest sense the impact of Sarbanes-Oxley on internal auditors and how audit departments are responding to the challenge. The research study neither attempts to evaluate the merits of Sarbanes-Oxley or related audit standards, nor aims to predict the success or failure of the legislation in

accomplishing its intended purpose of improved financial disclosure.

The report begins with a summary of the requirements of Sarbanes-Oxley for public companies and public accounting firms and a broad discussion of some of the immediate impacts and consequences experienced by both publicly held and private companies. The next chapter explains the methodology behind the research. The researchers gathered initial information from four focus groups of internal auditors. The focus groups, held in New York, Los Angeles, and Las Vegas, included auditors representing large and small public companies and members of The IIA and The Information Systems Audit and Control Association (ISACA).

Focus group discussions covered a comprehensive range of subjects related to today's regulatory and financial disclosure environment and their impact on a modern internal audit department. Auditors likely will find the summary of the study discussions — Chapter 3 — very informative.

Among the topics discussed in the focus groups were the significant changes companies had experienced in the new regulatory environment. These included changes in board and audit committee composition, whistleblower hotlines, managing Sarbanes-Oxley implementation, and the development and implementation of new or revised codes of conduct.

Internal audit managers generally experienced the impact of the new regulatory requirements through a stronger relationship with their board, more significant reporting responsibilities and advisory roles, and improved relationships with external auditors. Demand for internal auditing has increased along with the pressure for audit management to recruit, manage, and retain skilled staff.

INSIGHT FROM CASE STUDIES

The group discussions allowed researchers to identify potential case studies. Chapter 4 begins the core of the research report — 10 case studies drawn from the internal audit departments of some of the world's largest companies. Not all of the case studies are directly related to, or driven by, Sarbanes-Oxley implementation, but all are relevant to internal auditing in a post Sarbanes-Oxley world.

Case studies include [ISO 9001](#) certification by the internal audit department at the French electronics company Alcatel; coordination of internal and external audit planning at Axa, a Paris-headquartered insurance company; and introduction of an enterprise risk assessment process — similar to the framework since proposed by The Committee of Sponsoring Organizations of the Treadway Commission (COSO) — at a

division of New York-based American International Group, an insurance and financial services organization. The remaining seven case studies consist of a massive cultural and organizational change at Tyco, an international diversified manufacturing and service company; use of sophisticated data mining and analysis technology by IBM and Kinko's; and Sarbanes-Oxley implementation initiatives at Daimler Chrysler, Eli Lilly, Met Life, and Toys R Us.

Five case studies in *Changing Internal Audit Practices in the New Paradigm: The Sarbanes-Oxley Environment* illustrate the broad range of new internal audit practices examined in this research study:

- The decision by Alcatel Group Audit Services to seek certification under ISO 9001 was a brave customer-focused decision made at a time when the organization's customers are demanding more assurance.
- Tight professional integration of external and internal audit plans as described by AXA are critical to build confidence in auditing and to drive down assurance costs. Audit clients have long complained about duplication of effort, and the thinking and communication that coordination requires can only be beneficial to clients.
- Innovative application of data analysis software by IBM and Kinko's places them among the leaders in the field of developing key risk indicators, one of the hottest and potentially most valuable areas in audit and risk management. But the technology is not yet being applied to some of the most critical areas of reliable financial reporting.
- The Toys R Us case study, more than any other, spoke of training and skills development as well as capability building for Sarbanes-Oxley teams, management, and staff. Much can be learned from this; part of improving financial reporting is not just wanting to do so, but knowing how to do so.
- Tyco's story of radically changing its corporate governance framework and re-engineering its tone at the top serves as a road map for others to follow in the wake of governance failures.

BRINGING IT ALL TOGETHER

The final chapter of the book, appropriately titled "Bringing It All Together," is a comprehensive summary of the impact of Sarbanes-Oxley on internal auditing and on the public accounting profession and its clients, including private companies and not-for-profit organizations. Sarbanes-Oxley has changed the basic economics and business model of the public accounting profession, the basic governance practices and organizational structures of corporations, and the role and profile of the internal audit

profession.

NEW PARADIGM

The study initially seemed to lack focus and a central organizing theme. But that may be a reflection of the current state of the internal audit profession. The final chapter succeeds in bringing together and summarizing the many and complex impacts of the new regulatory environment and begins to look to the future.

Internal auditors should read this study to understand how their peers in other organizations are responding. The case studies are not intended to be best practices, but do offer insight into specific strategies that should be considered. Beyond that, internal auditing should be far more proactive. Reacting progressively to change is necessary for the profession. Influencing the regulatory environment, the professional standards, and tools is more important. The focus group discussions reveal real concerns with the standards, the tools, and the outcomes of the regulatory environment. The real value of this study is the insight it can provide internal auditors who want to move beyond compliance to influencing the regulatory environment.

It is not at all clear that a new paradigm has yet been created for internal audit. It is clear that one is needed.



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