A MATCH MADE IN HEAVEN?

THE TREASURY INTERNAL AUDIT REVIEW IS LOOMING AND YOU COULD DO WITH SOME EXTRA HELP. **DANIEL MOORE** OF ERNST & YOUNG RECOMMENDS TAKING THE OUTSOURCING ROUTE.

Are you looking forward to your next treasury internal audit review? Of course you're not – yet internal audit has the potential to provide value to your business. It can give senior management confidence that the treasury operation is effectively controlled (think AIB) and it can provide ideas on how to do things better (think benchmarking).

In the April edition of *The Treasurer* (page 23), I outlined the warning signs a firm should look out for that might indicate a potential problem within its treasury. I then explored the controls that every treasury should have in place to mitigate those risks. Once those controls have been designed, how does management ensure they are sufficient for the treasury operation? How does management know these are working effectively and continue to be appropriate for the business as it changes?

One obvious place to seek assurance is the firm's internal audit function. Management relies on internal auditors to be the objective 'eyes and ears' investigating risks and ensuring the controls are working as they were designed.

This is not easy to perform, especially in complicated areas such as treasury. One trend E&Y's Risk Management practice is starting to see in the internal audit market is to enhance the treasury internal audit function through outsourcing or partnering. Asking for assistance from another firm is not a new concept. However, given the treasury function is unique in an organisation, the 'drivers' behind asking for help are quite often different.

DRIVERS

The business community continues to be characterised by huge change that is making it more difficult to grow a business without accepting greater levels of risk or diminishing levels of return. Also, new financial products with growing sophistication are making it more difficult, particularly for senior management, to understand the complex nature of treasury.

The financial market also is undergoing vast change. Increased levels of competition, new and increasingly sophisticated distribution channels and rapid technological changes are expected to continue to be a feature of the changing market in which you operate.

There continues to be key changes in respect of regulation with which your business is expected to keep pace and which means you will be subject to a higher level of external scrutiny than ever before. An important aspect of regulatory change in the recent past and of the anticipated future changes such as N3, the proposed Basel II Accord and the Integrated Prudential Sourcebook is the need for high-quality risk management and assurance processes.

From a corporate perspective, accounting changes such as IAS 39/FAS 133 are impacting on the way treasury manages its risks.

RAISE THE BAR. Taking all these factors into account, I feel the main driver behind wanting external assistance with treasury internal audit is to 'raise the bar' to a level that would not be possible in-house, at a reasonable cost. Improving the quality of your treasury internal audit can materialise in three ways:

- skills and knowledge;
- tools and techniques; and
- culture.

For the internal audit function to deliver value to the organisation, the internal audit staff must continuously update their skills for business issues and audit techniques. Smaller organisations, facing the same business risks as their larger competitors, have difficulty ensuring their internal auditors have all the necessary skills. An external service provider can draw upon a much larger pool of competence in diverse areas such as business processes, information systems and regulatory compliance.

Because of economies of scale, your audit partner has access to structured training and their auditors have experience in reviewing similar business activities for other clients in the same industry. The ability to compare similar functions between different companies and benchmark against leading market practice provides added value.

From a technical point of view, immediate improvements in the capability of the internal audit function can be achieved. Some in-house auditors are relying too heavily on transaction based compliance tests that add limited value to an organisation. Outsourcing can provide an immediate change to more advanced techniques using risk-based methodologies that are executed by staff with experience in this area.

As I alluded to in the introduction, an organisation needs the culture that respects the role of internal audit and understands the value it can bring. An external provider can assist help bring about this change, if required. However, unless there is the right culture, your business will not get the potential value from internal audit.

PERKS OF HAVING A GOOD PARTNER. Recognising that a new audit approach, especially a risk-based and business focused one, will offer more tangible benefits than traditional internal audit approaches, cost reduction may not necessarily be a prime motivating factor for internal audit outsourcing or partnering.

A true partnership in the design, supervision and execution of treasury related audits requires there to be mutual benefit for both parties. You should benefit from flexible and consistent access to specialist resources. You will also gain from enhanced assurance, independent relationships with the treasury and access to training, skills and knowledge transfer. Your partner needs to benefit from the certainty of contracted revenues at rates that reflect the level and knowledge of the specialist resources being supplied.

Of course, you could buy a whole new treasury internal audit team. However, expertise required to carry out internal audit work is expensive if employed full time and such specialists are only required for a number of weeks or months during the year. External service providers can provide the required expertise on an 'as needs' basis and will only charge for the period of service provided.

Outsourcing or partnering enables you to take advantage of expertise not available in-house. Why not draw on the knowledge of professionals whose sole purpose is to perform that particular function?

STAFF AVAILABILITY. The challenges facing most businesses relate to recruiting and retaining people to meet the increasing demand of regulators and changes to the business. Not surprisingly, companies in the UK now face a struggle to recruit and retain high calibre treasury internal auditors capable of aligning themselves more closely with the business they serve. Consequently, they are contemplating an alternative.

The difficult aspect with treasury is the high level of expertise required to carry out the task. Some internal audit departments experience a high staff turnover, which has a negative effect on the attitude and calibre of the remaining internal audit staff. If staff turnover is high, organisations incur the costs of recruiting and training staff, the cost and difficulty of which continue to rise. If an external adviser can be found, this cost is passed on to them.

HURDLES TO CLEAR

So you're convinced of the benefits, but what about the potential problems? There are a number of reasons you would want to consider such a move, but before you take that step there are a number of hurdles that require clearing.

COMMUNICATION. The communication skills of the partner you choose is the most vital aspect to making any partnership work. The internal auditor must not only have the ability to talk on a technical level to treasury personnel, but also be able to discuss the broad risks and controls to the senior audit personal and Audit Committee. Successful arrangements we have seen set clear rules of the engagement and then continue to be characterised by good formal and informal links. It is vital to have one person responsible for the partnership from both the company and the external provider. These two people should be comfortable with one another given the large amount of informal communication that will be required.

The partner should provide periodic status reports and be available to participate in quarterly audit committee and board of directors' meetings.

INDEPENDENCE. In December 2001, following the demise of Enron, the big accounting firms expressed support for a new regulatory structure to provide independent oversight of the profession's disciplinary and quality-control efforts. Additionally, to address investor concerns about a perceived lack of independence, our firm, as well as others, indicated a willingness to cease providing certain services to external audit clients – namely financial information systems consulting and internal audit outsourcing – and to help consider other reforms.

Since then, many reforms in corporate governance have already been instituted by the market. Audit committees are filling much more substantial roles. Financial statement and business risks are being discussed openly among audit committees, management, and auditors as never before. Audit committees and management are, by and large, not buying internal audit outsourcing services from their external auditing firm. Therefore, it is worth considering the independence of the firm you elect to assist with treasury internal audit work.

FEAR OF THE UNKNOWN. Unless outsourcing/partnering has been used by a company before, management may be nervous about changing. Similarly, the culture of the providers should fit with the company. The views of the staff should be considered to ensure they are made aware of the changes that are happening and what the impact will be on them.

One way of easing into such a venture is to run a pilot review of one aspect of the treasury operation. This will give you a good idea of how the engagement would work on a full-scale basis. Importantly, once underway, you should have an exit strategy if things are not progressing as planned. This may include a break or termination clause in the contract.

QUALITY. With bringing in new people with more skills, you would anticipate the quality of service to increase. It is no use your partner using relatively inexperienced auditors. One way to ensure quality of service is to look at their track record. You can check their credentials by asking to talk to 'reference sites' and arranging presentations by the people who are actually going to do the work.

A SENSIBLE MOVE. There are a number of good reasons why you would seek assistance from a partner to deliver your treasury internal audit services. Once you have made the decision to select a partner, don't underestimate the effort required to make such an arrangement work. However, if you work together, the benefits can be substantial. These benefits include providing more assurance for senior management over the controls in treasury, meeting new regulatory standards, challenging the business and adding value through benchmarking you with other organisations.

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