

Thai Military Bank— Internal Control Training Program

Final Report

**Prepared under Support for Economic Growth and
Institutional Reform—Financial Services (SEGIR-FS),
Contract No. PCE-I-00-99-00009-00, Task Order #806**

PricewaterhouseCoopers

October 2000

Thai Military Bank

Internal Control Training Program
Final Report

22 September 2000

Introduction

This report represents a summary of the work performed by PricewaterhouseCoopers (PwC) in relation to the Internal Control Training Program recently completed at Thai Military Bank (TMB).

Our report is set out under the following headings:

	Pages
I. Summary of work performed	3
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At this point, we would wish to extend our appreciation to the directors, management and staff at TMB for their cooperation and assistance throughout this program. In particular, we would like to thank the training department staff for their outstanding contribution to this program.

In addition, the support that we received from Development Alternative, Inc. and the Kenan Institute Asia has enabled this program to be successfully completed.

I. Summary of Work Performed

The detailed workplan was prepared and presented to TMB on 19 July 2000. After some discussion, it was then submitted to DAI on 11 August 2000.

That work plan was adopted and followed by our team. In summary, the work performed was as follows:

- Diagnostic Phase, in which some directors and the senior management team were interviewed to ascertain issues relating to internal control at TMB.
- High-level Internal Audit Department review, to assess the current structure, resources, methodologies, the type of work performed and the style and content of reports.
- Preparation of Training Material
- Presentation of Training Program to:
 - Directors and Senior Management
 - Middle Management
 - Internal Audit
 - Train the Trainers

- The Internal Audit department at TMB have been provided with guidelines on *“Establishing an Integrated Framework of Control (COSO) - Some Important Considerations”*.
- A *“Training Kit”* has been prepared (in Thai) for use by TMB in the roll out of the key elements of the Training Program.

Details relating to each of these tasks are set out on pages 4 to 20 of this Report.

II. Results Achieved

A. Diagnostic Phase

Private and Confidential

The Diagnostic Phase primarily comprised confidential interviews with directors and senior managers.

From our interviews, we would make the following observations about the Internal Control system at TMB.

PROS

- **Good people** →
- **Follow rules and regulations** →
- **Communication within the bank** →
- **Existence of controls** →
- **Position description** →
- **Performance evaluation** →

but... CONS

- Frauds still occur**
- Some rules are obsolete and cumbersome**
- Not throughout organisation**
- Most are detective controls**
- Not job description to specific person**
- Remuneration is not based on performance measurement**

The Internal Control system at TMB has not been modified to take account of significant changes in the business environment that have effected all organisations in recent years. Where new controls have been introduced, typically they have been “added on” to existing controls.

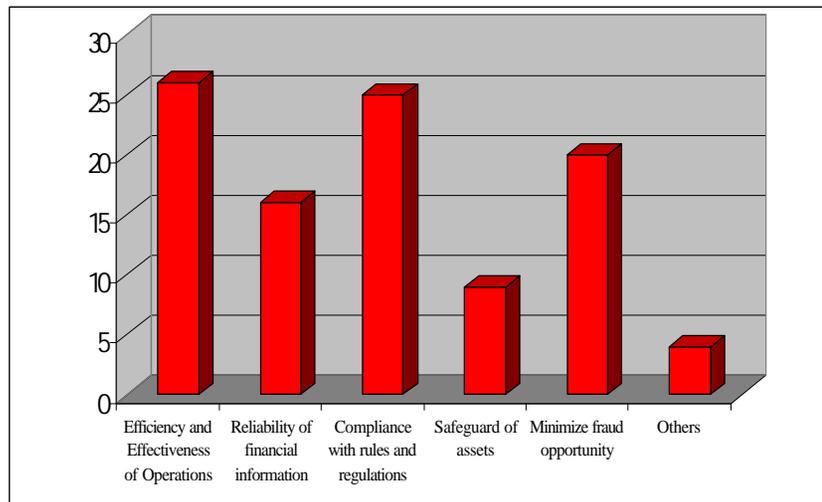
II. Results Achieved (continued)

A. Diagnostic Phase

Private and Confidential

During each interview, the participants were asked to complete a brief questionnaire - the results are shown in the tables below.

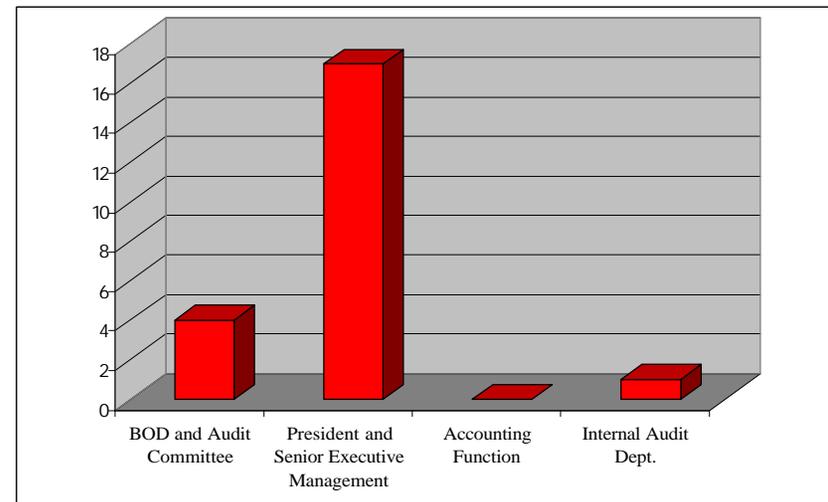
How would you rank the objectives of an effective Internal Control system?



Comments

- PwC would normally expect “Reliability of financial information” to be more significant.

Who is the owner of the Internal Control system at TMB?



Comments

- An appropriate response, although it should be understood by everybody in an organisation that Internal Audit does not have responsibility for internal control.

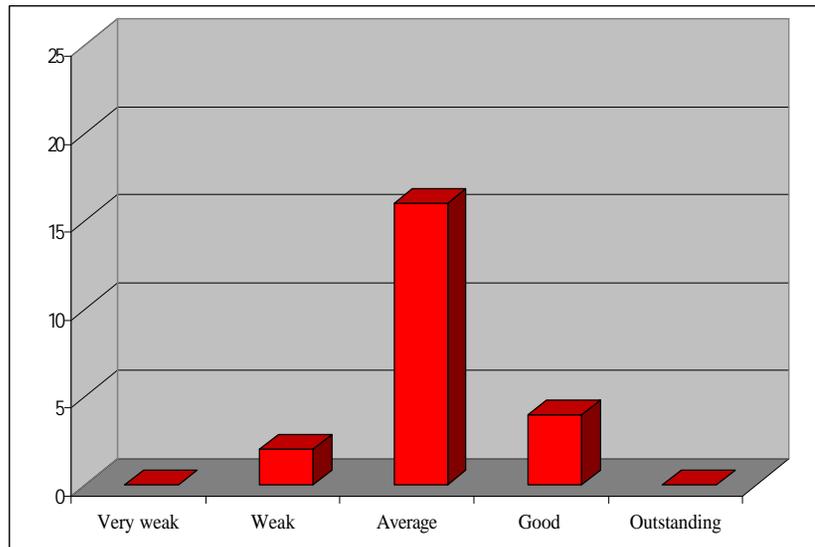
II. Results Achieved (continued)

A. Diagnostic Phase

Private and Confidential

Describe the effectiveness of Internal Controls at TMB?

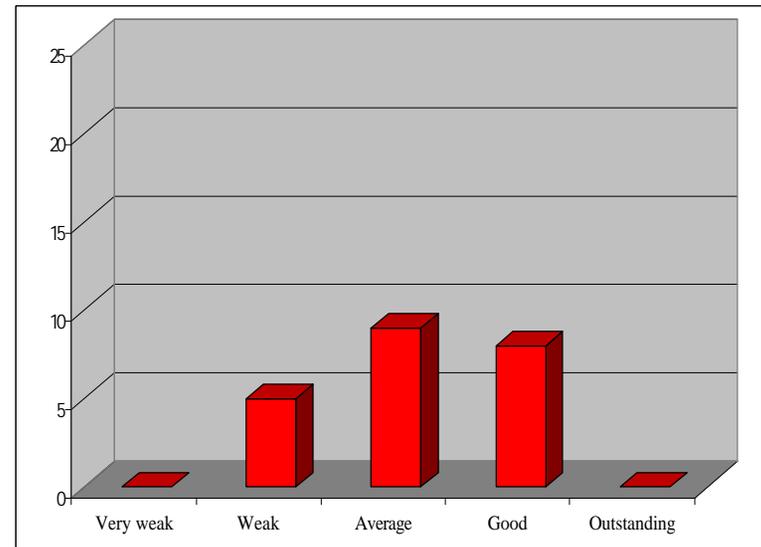
What is the level of understanding of Internal Control at TMB?



Comments

- For a major bank, a much higher ranking of control effectiveness is necessary.
- Senior management need to take more responsibility for improvements that need to be made to the TMB system of internal control.

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Comments

- The response to this question is not consistent with the surveys completed by middle management and internal audit during the training programs.

Thai Military Bank

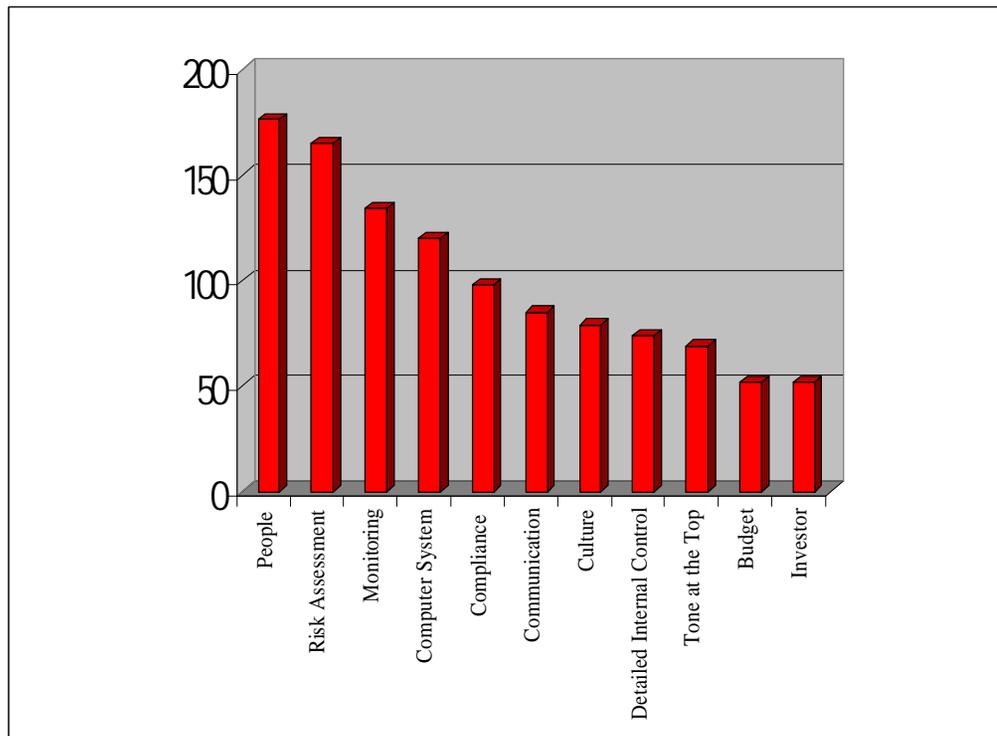
Confidential 6

II. Results Achieved (continued)

A. Diagnostic Phase

Private and Confidential

What are the key factors to promote the effectiveness of Internal Control?



Comments

- More emphasis necessary to promote the importance of “Communication” and “Tone at the Top” as key control requirements.
- Although “Risk Assessment” is seen as a key factor, risk management is not a core competency at TMB.

II. Results Achieved (continued)

A. Diagnostic Phase

Private and Confidential

The Diagnostic Phase identified some key areas where internal controls need to be improved.

These are described below:

TOP 5 FACTORS	TMB CURRENT STATUS	TMB'S NEED FOR IMPROVEMENT
<ul style="list-style-type: none"> Competence and integrity of people 	<ul style="list-style-type: none"> Staff have good background. However, there is no clear procedure to maintain "soft" control skills of people 	<ul style="list-style-type: none"> Policy from top management on "soft" controls
<ul style="list-style-type: none"> Understanding of risk management 	<ul style="list-style-type: none"> No formal process for identifying and analyzing risks of the bank and each of its activities 	<ul style="list-style-type: none"> Clear policy and understanding of risk management procedures Alignment of TMB's objectives, risks and controls
<ul style="list-style-type: none"> Effective monitoring procedures 	<ul style="list-style-type: none"> Internal audit activity is based on traditional approach Lack of training to promote staff's understanding of their control responsibilities 	<ul style="list-style-type: none"> New methodology for internal audit Improvement on IT audit Training on control-self-assessment
<ul style="list-style-type: none"> Efficient IT hardware and software 	<ul style="list-style-type: none"> Inefficient information technology e.g. non-timely, errors, no linkage of information 	<ul style="list-style-type: none"> Implementation of IT systems and information technology for management purposes
<ul style="list-style-type: none"> Detailed internal control procedures 	<ul style="list-style-type: none"> Excessive procedural rules to be followed 	<ul style="list-style-type: none"> Rules need to be updated to meet current business objectives

II. Results Achieved

B. Internal Audit Review

Objectives

A high level review of the Internal Audit Department at TMB by considering:

- The Internal Audit mission
- The organisation structure
- Methodology
- The Internal Audit plan and working papers
- Communication, reporting and follow-up
- Skill sets
- Tools and methodology

Results

- Major Findings - page 10
- Detailed Findings & Recommendations (Appendix A)

Procedures Performed

- Interviewed senior management of TMB including :
 - President
 - Executive Vice Presidents
 - Audit Committee
- Interviewed key people in the Internal Audit Department including :
 - First Vice President
 - Manager-in-charge of technical group
 - Manager-in-charge of head office audit group 1
- Discussion with selected audit teams and review of their audit working papers for selected projects :
 - Head Office Audit Group 4
 - Branch Audit Group 5
 - Computer Audit Group 2
- Comparison of findings to relevant best practices
- Developed suggested action steps

II. Results Achieved (continued)

B. Internal Audit Review - Major Findings

Private and Confidential

Issues to be Addressed

- Internal Audit's role has not been communicated to and the value of its services are not well respected by management.
- organisation structure within the Internal Audit Department does not support a formal sharing of information.
- The Internal Audit planning process only covers a 1 year period and is not aligned with TMB's strategic planning process.
- Working papers do not contain information to conform to documentation standards.
- Communication with and reporting to the business lines is not effective.
- Plans for staff development have not been clearly established.
- Tools and technology should be upgraded.

Work-in-Progress to be Accelerated

- Mission statement and Internal Audit charter are being developed.
- Internal Audit Department is currently assessing how to implement COSO.
- The risk assessment process is being updated. However, the process needs to be clearly linked with TMB's objectives.

Relevant Best Practice

- Reporting lines are adequate to ensure independence.
- Audit plan and reports are submitted to the Audit Committee for review and approval.

These issues are discussed in more detail in Appendix A, together with recommendations for improvement.

II. Results Achieved (continued)

C. Preparation of Training Material

- Training courses were prepared in Thai in accordance with the technical content specified in the Contract.
- Case studies and workshop discussion topics were developed with specific relevance to TMB and its operations.
- From the Diagnostic Phase, we ascertained that the concepts to be discussed in the training would be unfamiliar to the participants. This was “factored into” both the written material and the method of training.
- Preparation also included the development of the Internal Audit and Train the Trainers standard tests.
- All participants were provided with a course folder on arrival. No pre-reading or pre-course preparation was necessary or required.
- Guidelines were prepared by PwC on “*Establishing an Integrated Framework of Control (COSO) - Some Important Considerations*”. In discussions with TMB at the commencement of the project, this was put forward as their requirement and replaced the document referred to in the Contract as a manual covering “*Assessment of the Efficiency and Effectiveness of Work Operations*”. The draft Guidelines, which have not yet been discussed with TMB, are set out in Appendix B.
- A *Training Kit* was prepared in Thai. This comprised a series of PowerPoint slides and speaker notes, covering both technical content and teaching techniques. This material was used by the participants in the “*Train the Trainers*” course.

II. Results Achieved (continued)

D. Presentation to Directors and Senior Managers

Estimated Number of Attendees	Actual Number of Attendees	Number of Classes	Course Duration
37	22	1	3 hours

- The workshop commenced with a brief introduction from the Chairman, Khun Wimol Wongwanich
- The President and Chief Executive Office, Khun Somchai Sakulswarat closed the workshop
- The results from the interviews/questionnaires, as set out on pages 4-8 above. were presented to and discussed with this group
- This group was not asked to complete a Course Evaluation Form.

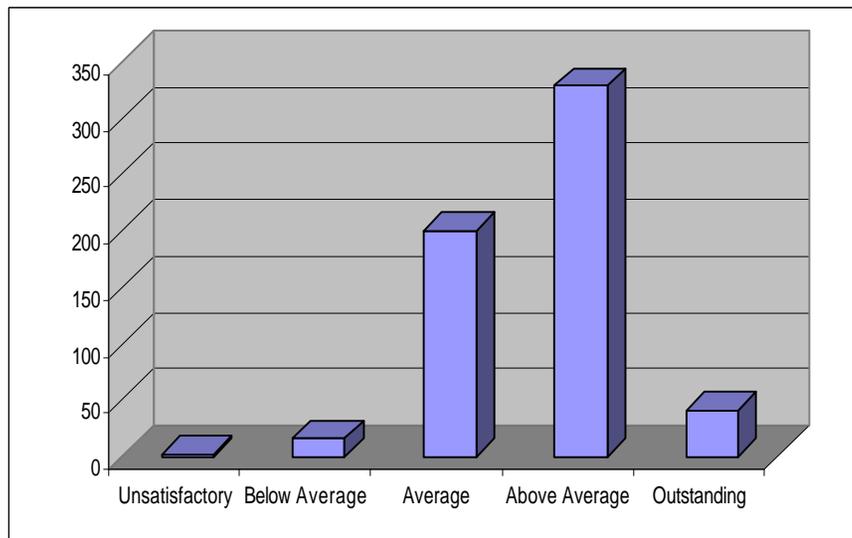
II. Results Achieved (continued)

E. Presentation to Middle Management

Estimated Number of Attendees	Actual Number of Attendees	Number of Classes	Course Duration
690	660	10	6 hours

- From the course evaluation forms, the overall course rating has been summarized in the graph below:

Middle Management Overall Course Assessment



- In the one day course and given the number of topics to be covered, it was only possible to provide the participants with an “awareness” of the concepts. Unfortunately, therefore, for many people the course was too short.
- The positive outcome from this “criticism”, however, is that the participants clearly wanted to learn more about governance, risk management and internal control - a need that TMB will need to address.

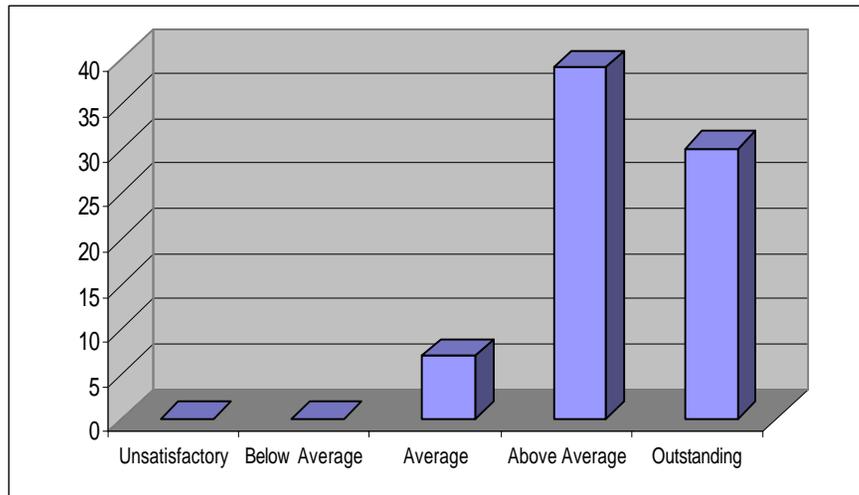
II. Results Achieved (continued)

F. Presentation to Internal Audit

Estimated Number of Attendees	Actual Number of Attendees	Number of Classes	Course Duration
70	80	2	5 days

- From the course evaluation forms, the overall course rating has been summarized in the graph below:

IA Overall Course Assessment



At the conclusion of the course, participants were asked in which areas should major internal audit work practice improvements be made at TMB. These were primarily identified as:

- transformation to a risk focus methodology
- “partnering”* with management
- improved training
- new technology to improve efficiency
- report formats.

II. Results Achieved (continued)

Internal Audit Course Assessment

- The results of the standard test for the Internal Audit participants, designed by PricewaterhouseCoopers, were as follows:

Score	Number Group 1	Number Group 2	Total
90-100%	11	8	19
80-89%	23	20	43
70-79%	2	6	8
60-69%	2	5	7
50-59%	-	-	-
40-49%	1	1	2
30-39%	1	-	1
	40	40	80

- Of the 80 participants, 87% achieved a score greater than the pass work; the benchmark was set at 80% in the Contract.
- Certificates of attendance will be presented to all participants by the President and Chief Executive Officer, Khun Somchai Sakulsawarat, on 29 September 2000.
- A “pass” mark of 70% was established as fair and reasonable, having regard to the nature of the questions and the relative skills and experience of the participants.
- All participants have been notified of their individual score.

II. Results Achieved (continued)

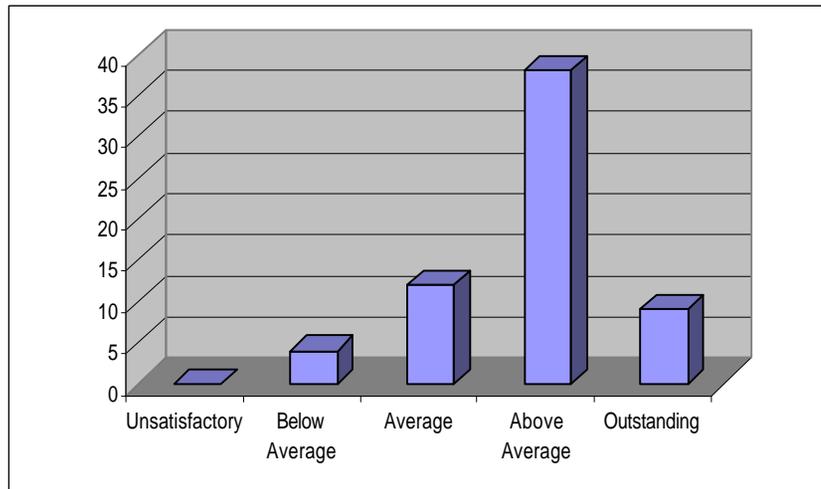
G. Presentation to Train the Trainers

Estimated Number of Attendees	Actual Number of Attendees	Number of Classes	Course Duration
70	66	2	4 days

- For some observations about the “*Train the Trainers*” course, refer to Section III - Problems Encountered, on page 18 below.

- From the course evaluation forms, the overall course rating has been summarized in the graph below:

Train the Trainers Overall Course Assessment



II. Results Achieved (continued)

Train the Trainers Course Assessment

The results of the standard test for Train the Trainers participants, designed by PricewaterhouseCoopers, were as follows:

Score	Number	Number	Total
	Group 1	Group 2	
90-100%	-	2	2
80-89%	-	26	26
70-79%	12	6	18
60-69%	13	1	14
50-59%	4	-	4
40-49%	1	-	1
	30	35	65

- Of the 65 participants, 71% achieved a score greater than the pass mark; the benchmark was set at 70% in the Contract.
- Certificates of attendance will be presented to all participants by the President and Chief Executive Officer, Khun Somchai Sakulsawarat, on 29 September 2000.
- A “pass” mark of 70% was established as fair and reasonable, having regard to the nature of the questions and the relative skills and experience of the participants.
- All participants have been notified of their individual score.

III. Problems Encountered

- Due to the length of time to complete the Contract negotiation phase, the project was delayed until 1 July start date. By that time one of key PwC team members was necessarily assigned to another project in the U.S.A., commencing mid August 2000.
- Unavoidably, at the commencement of the project, 2 weeks were lost in the “Mobilisation” stage as PwC team members were at that time assigned to other engagements.
- The wording in the final Contract reflected both the initial terms of reference and the agreed scope changes - some concern and confusion existed as to what work would be performed in the Diagnostic Phase. This was quickly resolved after discussions with all partners.
- The attendees at the “Train the Trainers” course were not selected by TMB for their actual or potential training skills - they comprised people from various business units, branch management, and from internal audit. Accordingly, we determined during the Preparation Phase that the Roll Out Plan would subsequently only constitute a brief (2 hour maximum) awareness course. The Train the Trainer course and Trainer Kit were prepared having regard to this assumption.
- During the 1st “*Train the Trainers*” course, some considerable discussion took place between some of the participants, TMB training people and PwC as to the structure and content of the course. As a consequence, PwC made revisions to the structure and content which to a large extent satisfied TMB. The root cause of the problem is explained below. The reworking of this course adversely affected both our preparation and presentation budgets.
- TMB had not considered how the “Roll Out Plan” from the “Train the Trainers” course would be effected:
 - who would be the “trainers”?
 - who would be trained?
 - what would the training comprise?
 - when would the training be conducted?

To some extent, this issue has not been resolved. TMB needs to determine when, how and by whom the “Roll Out and Implementation Plan” will be conducted.

IV. Next Steps

A. For TMB

- This training program has created an awareness amongst TMB management (ie. those who participated) of the importance and benefits of good corporate governance, risk management and internal control. For middle management, however, more than one day is required to train them to an appropriate extent - a significant number of respondents to the course evaluation commented on the need for more detailed training on these topics.
- The attendees at the Internal Audit course were primarily selected from the less experienced staff. The course must be offered to the senior members of the Department otherwise the application of the knowledge acquired by the attendees will be less than optimal.
- One of the fundamental components of an effective internal control framework is for an organisation to ensure that its desired Control Environment controls - values, ethics, *“tone at the top”* - reflect what actually happens in practice. This incorporates the corporate governance framework. A review of the existing corporate governance practices at TMB, a comparison to relevant best practice and the development of an agreed Action Plan for improvement would result in a considerable strengthening of the overall control framework at TMB.
- TMB has indicated its desire to implement an integrated framework of control. As part of this project, we have developed Guidelines entitled *“Establishing an Integrated Framework of Control (COSO) - Some Important Considerations”*. (See Appendix B) These Guidelines are in 2 Parts - Part I deals with organisational issues; Part II deals with Internal Audit issues. From our experience, TMB will require consulting assistance to successfully achieve its objectives this regard. The people from PricewaterhouseCoopers who have worked on this Internal Control Training Program have the necessary skills and experience.
 - a) to assist with implementation
 - b) to assist with the simultaneous reengineering of the TMB internal audit department.
- In the original Terms of Reference for this Internal Control Training Program, a US or European Study Tour was proposed for a number of people from the internal audit department. Whist this was replaced by the Diagnostic Phase described above, the Study Tour should still be considered as a future activity for TMB.

IV. Next Steps (Continued)

B. For Organisations other than TMB

- The Training Program - in its entirety or in part - is directly applicable to many other financial institutions in Thailand. Very few Thai companies have a clear understanding of the meaning, importance and benefits of corporate governance, risk management or internal control.
- However, in Thailand today, companies typically are not willing to invest in skills development; almost certainly the need is acknowledged but budgetary constraints impede commitment.
- The awareness of COSO in Thailand is quite high, because it has been strongly promoted for a number of years by organisations such as the Institute of Internal Auditors of Thailand. But what it actually means and, more particularly, how does an organisation approach implementation are issues that are not so well understood.

Thai Military Bank

Internal Audit Review-Detailed Findings and Recommendations

Guidelines prepared by PricewaterhouseCoopers

Thai Military Bank

Establishing an Integrated Framework of Internal Control (COSO) - Some Important Considerations

Guidelines prepared by PricewaterhouseCoopers

Establishing an Integrated Framework of Internal Control (COSO)

Part I - Organisation

Introduction

The following Guidelines set out the key issues that need to be addressed by an organisation that seeks to implement a “Risk-based Internal Control Framework” (that conforms with COSO). It is not intended to be a step-by-step manual.

The implementation of an integrated framework of internal control cannot be achieved by training alone. Training is an important component of internal control but a much broader approach is required.

Part I of these Guidelines deals with issues that need to be addressed by the organisation as a whole.

Part II covers those actions that internal audit should consider, as it transforms from a compliance orientation to a “business partner” with management.



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Contents

The Guidelines in Part I are set out under the following headings:

- I. What is COSO?
- II. The Benefits of Good Governance, Risk Management and Internal Control
- III. Leadership
- IV. Steering Committee
- V. Role of Management
- VI. Preliminary Assessment
- VII. Pilot Applications
- VIII. Role of Internal Audit
- IX. Role of the Audit Committee
- X. Control Self-Assessment
- XI. Role of Train the Trainers
- XII. Role of Independent Consultant
- XIII. Action Plan
- XIV. Implementation
- XV. Timeframe

Thai Military Bank

Establishing an Integrated Framework of Internal Control (COSO)

Part I - Organisation

I. What is COSO?

The Committee of Sponsoring Organisations (COSO) of the Treadway Commission issued a report in 1992 entitled “Internal Control - Integrated Framework”. This brought together widely differing views about internal control into what has now become generally recognised as a world’s best practice approach to internal control.

Internal control is a process, effected by an entity’s board of directors, management and other personnel designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- effectiveness and efficiency of operations
- reliability of financial reporting
- compliance with applicable laws and regulations.

Key concepts:

- internal controls are most effective when “built into” operating activities
- people at every level in the organisation have responsibility for internal controls
- internal controls cannot provide absolute assurance
- internal control is a major component of an effective corporate governance framework
- an integrated internal control system cannot be implemented without an entity-wide approach to risk management.



**Key
Success
Driver**

Modern, competitive banks have recognised the importance of internal control.

Establishing an Integrated Framework of Internal Control (COSO)

Part I - Organisation

II. The Benefits of Good Governance, Risk Management and Internal Control

From a banking industry perspective, corporate governance involves the manner in which the business and affairs of the bank are governed by their board of directors and senior management, affecting how the bank

- sets corporate objectives (including generating economic returns to its owners)
- runs the day-to-day business operations
- considers the interests of all recognised stakeholders, including employees, customers, financiers, suppliers, the community, supervisors, regulators, government
- aligns corporate activities and behaviours with the expectation that the bank will operate in a safe and sound manner, and in compliance with applicable laws and regulations
- protects the interests of depositors.

External studies show that some or all of the following benefits can be enjoyed those organisations that can demonstrate good corporate governance:

- improved business performance
- improved access to capital
- lower cost of capital
- premium on share price
- attractive for current and potential employees.

But for these benefits to be derived, an organisation has to be prepared to conform to recognised standards of good governance in all respects. The organisation must be prepared to embrace the changes that might be required. Risk management and Internal Control are two important components of a corporate governance framework. And an effective internal audit function will enhance good governance within an organisation.



**Key
Success
Driver**

There is no doubt - now proven through various external studies - that organisations which can demonstrate that they practice good corporate governance are more favourably regarded by the global markets.

Establishing an Integrated Framework of Internal Control (COSO)

Part I - Organisation

III. Leadership

Boards of directors have the responsibility to define their expectations for good corporate governance and to ensure that an internal control system is effective.

Management, at all levels, is responsible for the internal control system, whilst the chief executive has ultimate ownership responsibility.

The decision to implement COSO in an organisation can only be made by the board of directors and the chief executive. The decision should be made in the full knowledge that implementation cannot be achieved “overnight”, that a commitment to the internal control project is fundamental and that people charged with the responsibility for implementation must be “passionate” about the benefits.

A formal “launch” of the project should be communicated to all employees by the chief executive.

Regular progress reports should be prepared for/by the chief executive to ensure that the importance of the project is maintained.

A communication from the chief executive should always contain a reference or linkage to the internal control project.

The chief executive should establish a Steering Committee to be responsible for the internal control project.



**Key
Success
Driver**

Top management must accept, embrace and communicate the compelling need for an integrated framework of control.

Establishing an Integrated Framework of Internal Control (COSO)

Part I - Organisation

IV. Steering Committee

A project of this significance and complexity cannot be successfully implemented without leadership.

The role of the Steering Committee is to ensure that the decision made by the board of directors and chief executive is carried out efficiently and effectively. The chief executive may wish to chair the Steering Committee as evidence of his/her commitment to the project.

The Steering Committee should comprise people who have:

- the ability to make decisions concerning internal controls
- knowledge of the operations
- a desire to work in a “best practice” environment
- a commitment to the success of the project
- expertise in corporate governance, risk management and internal control.

An independent facilitator/consultant to the Steering Committee can ensure that the agreed timelines and actions are achieved, and can provide the expertise described above.

The Steering Committee is responsible for developing an Action Plan for the project, for approving policy changes to the system of internal control and most specifically for the implementation of an integrated internal control framework.

However, the Steering Committee should not be considered as a “permanent” committee of the organisation, only needing to operate to the conclusion of the project.



**Key
Success
Driver**

The Steering Committee would represent the Change Agent for a predetermined period of time.

Establishing an Integrated Framework of Internal Control (COSO)

Part I - Organisation

V. Role of Management

Management will provide the appropriate environment to encourage all staff to embrace this project. Without evident and active management support, the project will not achieve its objectives.

From time to time, staff will be required to participate in training, workshops, control self-assessment teams. Without disrupting the activities of the organisation, management must encourage their involvement. This project needs the participation of everybody.

Line Management will also be required to consider and assess the risks and related controls identified during the project.

A desired outcome is a better understanding of the risks faced by the organisation and assurance that relevant and appropriate internal controls are in place to prevent the likelihood that those risks will occur.

Management will need to accept that the establishment of an integrated framework of control necessarily involves changes to the culture and work practices of an organisation. Accordingly, projects of this nature frequently require support from change management specialists who can assist management adapt to new practices.



**Key
Success
Driver**

The nomination and appointment of “control champions” to each department will encourage buy-in from management.

Establishing an Integrated Framework of Internal Control (COSO)

Part I - Organisation

VI. Preliminary Assessment

A necessary starting point is to conduct a preliminary assessment of the adequacy or otherwise of existing governance, risk management and control practices.

To some extent this has been performed as part of the Internal Control Training Program conducted by PricewaterhouseCoopers. The results from that program would need to be considered by the Steering Committee to determine whether the internal control diagnostic phase needed to be extended and applied to a broader cross-section of employees/operations. It would also be necessary to ensure that the Steering Committee had a very clear picture of the existing governance and risk management practices and the related “gaps” to relevant best practice.

One of the early tasks of the Steering Committee would be to initiate an enterprise-wide internal control awareness program. The roll-out of the Internal Control Training Program by the “trainers” should be a high priority.

The preliminary assessment and the awareness program would create a “roadmap” of what needs to be done to implement the control framework.



**Key
Success
Driver**

Once the project has commenced, “drop” any reference to COSO and describe the project either as governance, risk management or internal control.

Establishing an Integrated Framework of Internal Control (COSO)

Part I - Organisation

VII. Pilot Applications

A small representative sample of business units and business processes should be selected, such that pilot risk and control assessment programs can be performed on a trial basis.

The primary objective of the pilot program would be to confirm that the ORCA methodology (Objectives - Risks - Controls - Alignment) can be successfully applied in practice.

A combination of individual assessments and group workshops would be required. A standard or pro-forma worksheet would enable consistent reporting to line management and the Steering Committee.

Ultimately, the ORCA methodology will need to be applied for each business unit and each stand-alone business process.

An important pilot project would be to include the “corporate head office”, comprising representatives from the board and/or senior management. This would not only identify the high-level enterprise wide objectives, risks and controls, but it would also demonstrate commitment to the project at the highest levels. Their involvement in a successful pilot project will ensure their continued enthusiasm for the project as a whole.

An evaluation of the pilot applications should be carried out by the Steering Committee prior to commencement of the Control Self-Assessment program.

The primary outcomes from the pilot applications would be an agreed methodology and an approved reporting format, to be used throughout the Control Self-Assessment program, as described in Section X below.



**Key
Success
Driver**

Early wins will help convince people of the benefits of the project.

Establishing an Integrated Framework of Internal Control (COSO)

Part I - Organisation

VIII. Role of Internal Audit

Internal Audit should play a major role in the governance of an organisation. Whilst its primary responsibility is to “monitor” the adequacy and effectiveness of the internal controls, it can play a leading role in the implementation of an integrated internal control framework.

An internal audit representative should be allocated to each pilot application. With their enhanced knowledge of the principles of risk management and internal control, their role would be to work with the project teams, provide their technical knowledge and generally contribute to the successful completion of the pilot applications and then to the roll-out of the project as a whole.

Recurring internal audit fieldwork should focus on the risk and control assessments, which should have identified the major risks relevant to a particular business unit or process. Internal audit would need to confirm that the assessments are being regularly updated - as new products, systems, regulations are introduced - and that the controls identified are operating as anticipated.



**Key
Success
Driver**

A reengineered internal audit department can make the transition to “business partner” and can be a valued contributor to the overall performance of the organisation.

Establishing an Integrated Framework of Internal Control (COSO)

Part I - Organisation

IX. Role of the Audit Committee

One of the key responsibilities of the Audit Committee is to ensure that the organisation operates an effective internal control system. The Audit Committee is required to report to the shareholders in the Annual Report on the effectiveness of the internal control system.

A statement in the Annual Report - and such other documents to the public, to creditors, or to the regulators - that the organisation is working towards establishing an integrated framework of internal control, including an enterprise-wide approach to risk management, would send a powerful message to the market.

The Audit Committee should review the activities of the Steering Committee, ensuring that the project maintains its momentum and focus. The minutes of the Steering Committee should be forwarded to the Audit Committee and quarterly reports on progress should be prepared by the Steering Committee.

The Audit Committee should also directly monitor the internal audit reengineering project, described in Part II of these Guidelines.

Whilst it would not be necessary for the Audit Committee to review in detail the risk and control assessments prepared by each workgroup, at some point in time a “consolidated” enterprise-wide risk assessment should be prepared for the Audit Committee and the board of directors.



**Key
Success
Driver**

The Audit Committee must understand and support all of these initiatives. This needs to be seen as a governance project, initiated by the Audit Committee and the Chief Executive.

Establishing an Integrated Framework of Internal Control (COSO)

Part I - Organisation

X. Control Self-Assessment

The principles of control self-assessment - whereby workgroups, comprising people responsible for particular business units or specific business processes, are established to identify and assess business risks and controls relevant to their areas of responsibility - are particularly appropriate as a technique to implement an integrated internal control framework.

Control self-assessment enables a wide range of people to participate in the development and enhancement of the governance of the organisation. It is a technique that readily facilitates continuous improvement, can be linked to other quality initiatives of the organisation and which can form the basis for the sustainable implementation of a risk and control culture.

For control self-assessment to be effective, management needs to actively support and contribute to the process. The people who participate in control self-assessment need to be familiar with the operations under review. Guidance and assistance can frequently be obtained from internal audit and/or the “champions” of control, as described in Section XI below.

A direct benefit from control self-assessment is that staff begin to see themselves as the “owner” of risks and controls, such that they can more easily identify and support control improvements.



**Key
Success
Driver**

**Internal control is effected by people in the organisation.
Therefore, everybody needs to be involved. CSA provides that environment.**

Establishing an Integrated Framework of Internal Control (COSO)

Part I - Organisation

XI. Role of Train the Trainers

The Internal Control Training Program included a “Train the Trainers” course, attended by 70 people. The primary objective of this course was to provide the participants with a clear understanding of the principles of a good internal control system together with appropriate teaching techniques. A Trainers Kit was issued to all participants, designed to enable the participants to conduct up to 2 hours of training on corporate governance, risk management and internal control .

A compulsory induction course should be initiated by the organisation’s Human Resource/Training Department to ensure that all new employees - at all levels - receive up to 2 hours of training on these important principles.

Immediately prior to the commencement of the Pilot Applications and the subsequent roll-out across the organisation, the Trainers should conduct their training program with the work group participants. This will ensure that the knowledge transfer is both relevant and timely. “Champions” from the Train the Trainers course should also be assigned to each workgroup.



**Key
Success
Driver**

Training will always be required. People’s need for training will vary, but its importance cannot be underestimated nor can the investment be withheld.

Establishing an Integrated Framework of Internal Control (COSO)

Part I - Organisation

XII. Role of Independent Consultant

Organisations that attempt to undertake these types of projects without the assistance of experts, typically fail to achieve their objectives, take much longer than anticipated, underestimate the resources required, lose momentum and motivation, lack the necessary technical knowledge and experience, transfer key project staff to other competing internal priorities.

The independent consultant can provide solutions to these issues and thereby significantly enhance the likelihood of the project's success. Apart from providing expertise, the independent consultant would:

- act as the project manager, reporting to and working with the Steering Committee
- ensure that the agreed deliverables and timeframe are achieved
- ensure that relevant best practices were applied, and
- commit to their knowledge and skills being “transferred” to those staff who directly participate in the project.



**Key
Success
Driver**

**People with experience implementing risk and control frameworks
in large organisation are an essential investment.**

Establishing an Integrated Framework of Internal Control (COSO)

Part I - Organisation

XIII. Action Plan

After completion of the pilot applications, an Action Plan for the organisation-wide roll-out of the project needs to be prepared by the Steering Committee. The Action Plan should describe which applications are to be reviewed (by applying Control Self-Assessment techniques), timing and workgroup responsibilities. As noted above, a representative from internal audit and from the Train the Trainers program should be assigned to each work group.

Reports (ie. Risk and control worksheets) prepared by the workgroups would initially be reviewed by and discussed with responsible line management before being passed to the Steering Committee for approval.

Progress of each workgroup needs to be carefully monitored by the Steering Committee to minimise project slippage and to ensure that adequate and appropriate resources are available to meet the project objectives.



**Key
Success
Driver**

As with any large project, the Action Plan must describe what needs to be done, by whom and by when. The independent consultant/project manager can maintain enthusiasm and commitment.

Establishing an Integrated Framework of Internal Control (COSO)

Part I - Organisation

XIV. Implementation

At the Corporate level, successful implementation requires:

- agreement and understanding of the corporate objectives
- identification and assessment of those risks that might prevent the organisation from achieving its objectives
- relevant and effective internal controls to manage those risks.

At the branch or department level, successful implementation requires a similar understanding of those objectives, risks and controls that are directly applicable to those operations, ensuring that they are aligned to the corporate strategy and values.

At the business process or sub-process level, a further breakdown of relevant objectives, risks and controls needs to be identified, confirmed and communicated.

These Guidelines have described an approach as to how this can be implemented by an organisation.



**Key
Success
Driver**

While implementation can be regarded as a “one-off” project, the internal control framework - objectives, risks and control - will become a dynamic process. As events, circumstances, people change, so the framework will need to be reassessed.

Establishing an Integrated Framework of Internal Control (COSO)

Part I - Organisation

XV. Timeframe

The challenge of successfully implementing an integrated internal control framework should not be understated. It cannot be achieved by issuing a new policy, or by preparing and issuing a manual. It requires commitment, resources and expertise.

But by adopting a proven approach, as set out in these guidelines, the organisation can expect:

- fewer and more effective controls
- continuous risk management process
- reduced risk to reputation
- better information for decision making
- improved allocation of resources
- enhanced shareholder value.

Whilst the length of time necessary to implement a control framework obviously depends on the size and complexity of an organisation, real benefits can be expected to accrue as soon as people become involved in the project. This is already evident from the results of the Internal Control Training Program.

The project should be commenced without a definitive deadline specified, but a 3 monthly project evaluation would ensure focus is maintained and benefits achieved.



**Key
Success
Driver**

A key performance metric of 70% effective implementation in Year 1 should be established.

Establishing an Integrated Framework of Internal Control (COSO)

Part II - Internal Audit

Introduction

Internal audit should seek to play a major role in the governance of an organisation. In most well governed organisations, internal audit can strive to apply best practice internal audit techniques in the full knowledge that the board of directors and senior management will support such initiatives.

Accordingly, internal audit should determine its strategic direction, having regard to relevant best practices, and seek agreement to that strategy from the appropriate stakeholders in the organisation.

Part II of these Guidelines describe some of the issues that need to be considered by internal audit in the adoption of one such relevant best practice, namely the application of an integrated framework of internal control (COSO) to its methodology.

Definitions from COSO and a description of the key concepts are set out in Part I of the Guidelines.

Contents

The Guidelines in Part II are set out under the following headings:

- I. organisation
- II. Leadership
- III. Action Plan
- IV. Pilot Applications and Control Self-Assessment
- V. Communication
- VI. Independent Evaluation



Establishing an Integrated Framework of Internal Control (COSO)

Part II - Internal Audit

I. Organisation

At the outset, it must be emphasized that internal audit cannot successfully apply COSO to its methodology unless the organisation has also embraced the principles of COSO.

In practice, this means that there must be a commitment from the board of directors and senior management that the key concepts of COSO reflect values that need to be integrated into the culture and business practices of the organisation. Without this commitment - which needs to go beyond just policy endorsement - internal audit will continually fail to achieve its own performance standards and will not be able to engage its customers in effective discussion. The consequences will quickly result in frustrations and disappointment as both parties believe that their respective objectives are not being achieved.

Therefore, the decision to establish an integrated framework of control must initially be made by the board of directors, Audit Committee and management, with a corresponding agreement by internal audit that it will re-engineer its existing practices and techniques to ensure that it can successfully fulfil its obligations under the control framework.

It is equally true that if an organisation commits to the application of a control framework, and this is not supported by internal audit, then a key component of the framework will be missing, thereby threatening the success of its implementation.



**Key
Success
Driver**

Implementing an internal control framework and reengineering the approach to internal audit must occur simultaneously.

Establishing an Integrated Framework of Internal Control (COSO)

Part II - Internal Audit

II. Leadership

As with any project, support from the top is an essential success factor. This equally applies to the leadership team of the internal audit department. Absolute commitment from the leader and buy-in from the senior members of the department is fundamental.

An Implementation Committee should be established within the Internal audit department to:

- develop the strategic vision for internal audit
- provide on-going guidance and leadership to the implementation project
- develop and monitor the Action Plan for implementation.

The Chairperson of the Implementation Committee should be nominated as the internal audit representative on the Steering Committee, as set up by the organisation to achieve enterprise-wide application of the control framework.

The necessity of engaging the services of an independent consultant - an organisation that has both the experience and the resources to add value to the project - should be carefully evaluated. The range of tasks to be performed can often be beyond the capabilities of in-house personnel, and on-going day-to-day responsibilities of the internal audit department need to be continued whilst the project evolves.



**Key
Success
Driver**

Successful reengineering cannot be achieved without genuine commitment from the top.

Establishing an Integrated Framework of Internal Control (COSO)

Part II - Internal Audit

III. Action Plan

An Action Plan that clearly sets out what needs to be done, by whom and by when should be developed by the Implementation Committee.

The basic deliverables that would be expected from the project would include:

- Mission statement
- Internal Audit charter
- Methodology
- Evaluation tools and techniques
- Technology strategy
- Manuals
- Training program
- Communication
- Pilot application of IA methodology
- Control self-assessment

In order to successfully reengineer a large internal audit department, such that its approach to internal audit conforms to and has the capacity to evaluate, monitor and improve an integrated framework of control, the Implementation Committee must acknowledge that the project will require a substantial commitment and investment of time and resources.

The Action Plan should be consistent with the Steering Committees' Action Plan and approved by the Audit Committee. Progress on deliverables should be reported to and monitored by the Audit Committee.

As part of the Internal Control Training Program, a high level review of the internal audit department at TMB was performed. The results of this review should be considered by the Implementation Committee as it develops the Action Plan.



**Key
Success
Driver**

Completing the project on time will ensure that the benefits can be realized to their maximum effect.

Establishing an Integrated Framework of Internal Control (COSO)

Part II - Internal Audit

IV. Pilot Applications and Control Self-Assessment

There are three important concepts that need to be understood and applied by the organisation in order to successfully adopt an integrated framework of control, namely:

- Risk management
- Internal control
- Control self-assessment

With the completion of the Internal Control Training Program, a large number of people now have an awareness of these concepts. Some of the people who attended the “*Train the Trainers*” and “*Internal Audit*” courses have considerable knowledge of these concepts.

From these people, “*champions of risk and control*” should be selected to launch the pilot applications; selected branches, business units, business processes which would be representative of the organisation as a whole.

Internal audit should participate initially as a facilitator, and ultimately as “*an expert*”, to the extent possible without adversely impacting its independence, in the control self-assessment workshops.

Subsequently, internal audit should apply its revised approach - as developed through the Action Plan - to the pilot applications. In this way, it can be anticipated that the auditee will understand the internal audit approach and will be able to perceive the value and linkage between the control self-assessment process and the approach adopted by internal audit.

Issues arising from the pilot applications can be considered by the Implementation Committee and, if warranted, revisions made to the internal audit documentation. On completion of the pilot applications, internal audit can apply its methodology to the organisation as a whole, keeping the roll-out consistent with the timing of the wider application at TMB.



**Key
Success
Driver**

Involving people with the best knowledge and skills from TMB and using external consulting support will maximize the success of the pilot projects.

Establishing an Integrated Framework of Internal Control (COSO)

Part II - Internal Audit

V. Communication

A critical component of a successful reengineering project is to communicate with those stakeholders that will be impacted by the change. In this regard, a forward plan should be developed to encompass the different types of communication that will be applied in, say, the initial 12 month period. These might include:

- Presentations - formal and informal
- Newsletters
- Informal call-program
- On-the-job discussion
- Entertainment

Changes will also be necessary to the way in which internal audit “*communicates*” its findings from audit work performed. Management are looking for value added, proactive recommendations. By focussing the audit effort on the high risk activities of the organisation, internal audit should be able to make a significant contribution to the lowering of the risk profile, and should be able to look at the efficiency and effectiveness of the activities of the organisation with a performance improvement focus to its work.

Planning meetings will be the initial contact between internal audit and management and therefore will assume more importance; close-out or exit meetings will be need to become a more strategic component of the methodology; and reporting formats will need to be revised.



**Key
Success
Driver**

Effective and timely communication is an important control component. The success of the project depends on how management outside internal audit can be convinced of the value internal audit can bring to the organisation.

Establishing an Integrated Framework of Internal Control (COSO)

Part II - Internal Audit

VI. Independent Evaluation

A high level review of the internal audit department was conducted by PricewaterhouseCoopers as part of the Internal Control Training Program.

An increasing trend amongst the better governed organisations is for Audit Committees to seek regular (e.g. every 3 years) independent evaluations of the performance of their internal audit department.

Reviews of this nature should not focus on past practices; they should be more strategic. Greater benefit can be derived from an evaluation of what management expects from internal audit and comparing those expectations to current practices, resources and deliverables.

Progress against the Action Plan and the application of the new approach in the pilots and enterprise-wide roll-out should be a particular objective of the evaluation at the end of Year 1.

It should be noted that in the Standards for Professional Practice of Internal Auditing, an Exposure Draft is currently on release which suggests that independent reviews be conducted at least once every 5 years. This typically would apply to a well-established, modern internal audit function. More frequent reviews are justified for organisations undergoing major revisions to their risk and control culture.



**Key
Success
Driver**

Assurance that the implementation of the new internal audit methodology is generating positive benefits for the organisation should be of real value to the Audit Committee.