CHAPTER 1

PROCESS-DRIVEN REPORTING

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Writing, like auditing, is a systematic process. Contrary to popular myths about wild-eyed literary celebrities—and widely held perceptions that math and verbal skills are mutually exclusive—writing is a lot like computer programming, especially report writing.

REPORT WRITING AS PROGRAMMING

Like programming, report writing is going after something: a conclusion to be reached and acted on, a successful delivery of information, a new set of results or outputs to be acknowledged. Creating an "A-ha!" moment for Audit Committees, Chief Audit Executives (CAEs), and managers, similar to what programmers experience when the data runs successfully against the software they have written, is something for internal auditors to aspire to when writing reports.

Report writing also proceeds logically, from one step to the next, including whatever supports the thesis and discarding whatever is unnecessary or distracting. Anyone who has ever watched a computer program "loop" understands the importance of proceeding systematically from A to B to C, without skipping B. And anyone whose

manager has ever fired back a red-lined draft of an internal audit report knows that including only relevant content is an absolute requirement.

Like effective programming, effective report writing also stands the tests of time, multiple users, and multiple interpretations. Screenwriters call that quality "making lines actor-proof"; internal auditors might call it "making causal relationships transparent." Although people often interpret the same words differently, it is possible to write so that most of the readers will be in consensus—at least about the most important points, and at least the most important readers.

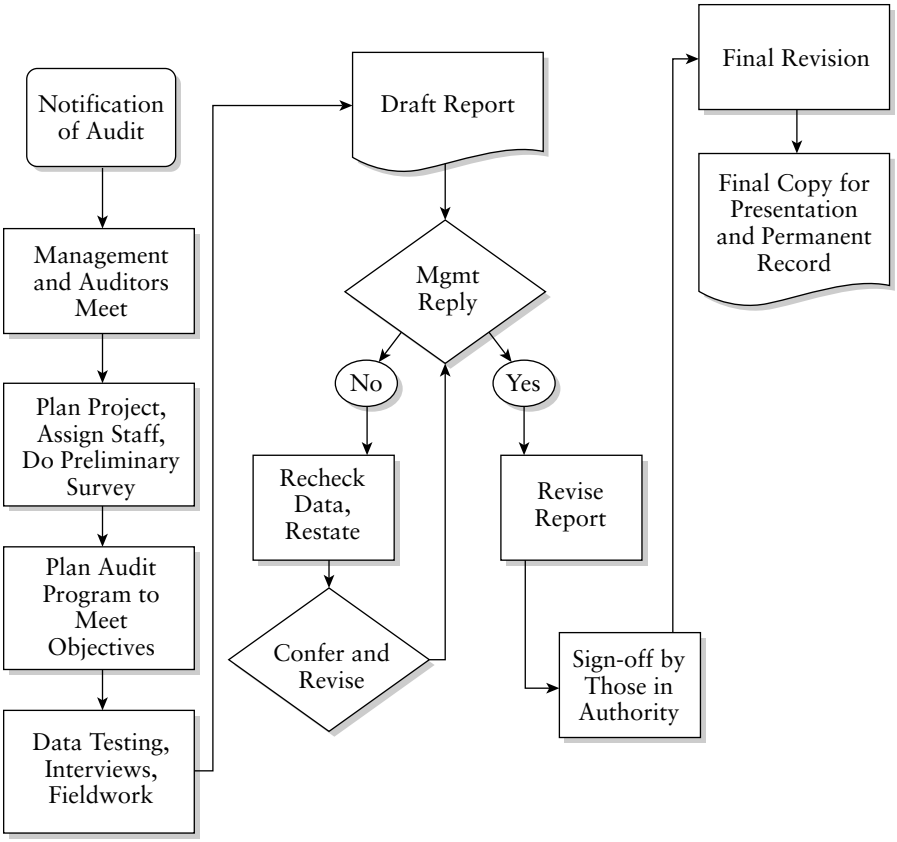
A typical programming flowchart begins at the starting point oval and goes on to include rectangles indicating activities, diamonds representing decision points, and curled-edge boxes showing document output. Using those same symbols, a Generic Audit Process flowchart is shown in Exhibit 1.1. The terminology will differ depending on whether the audit is a Sarbanes and Oxley (SOX) audit or a traditional financial or operations audit; however, the same logical process applies.

The Audit Process begins with a request for an audit, or notification of one, and proceeds through various activity steps. Each step—whether it comprises the formal audit conference, fieldwork planning meetings, on-site controls testing, status briefings, completion and review of work papers, high-priority e-mails requesting access to additional files, or conversations with managers, CAEs, or audit committee members—involves communication. Much of that communication is written.

The Report Writing Process also begins with the notification of an audit. The written report is not a separate task to be tacked on—and tackled—after the real work has been accomplished. Data gathering for the report begins with the first documents that refer to that particular audit, and the mental work of writing begins then as well. To save time at the end, start thinking about the report from the beginning.

Each of the steps in the Report Writing Process flowchart (see Exhibit 1.2) directly reflects the activities of the audit process; in fact, some are identical.

EXHIBIT 1.1 *Generic Audit Process*



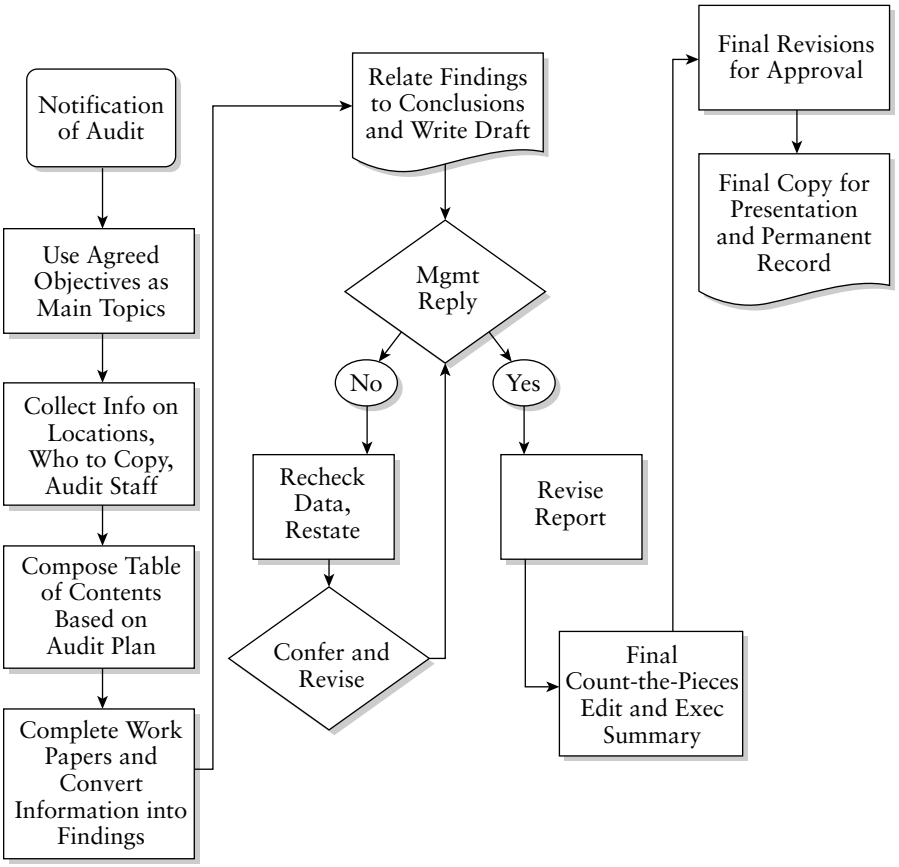
A flowchart for the Comprehensive Audit Reporting Process is shown in Exhibit 1.3.

Before describing the seven steps, a quick look at the process as a whole is in order.

PROCESS-DRIVEN REPORTING DEFINED

Process-driven reporting is not really new; however, the emphasis on process—that is, looking at the path taken by information through a

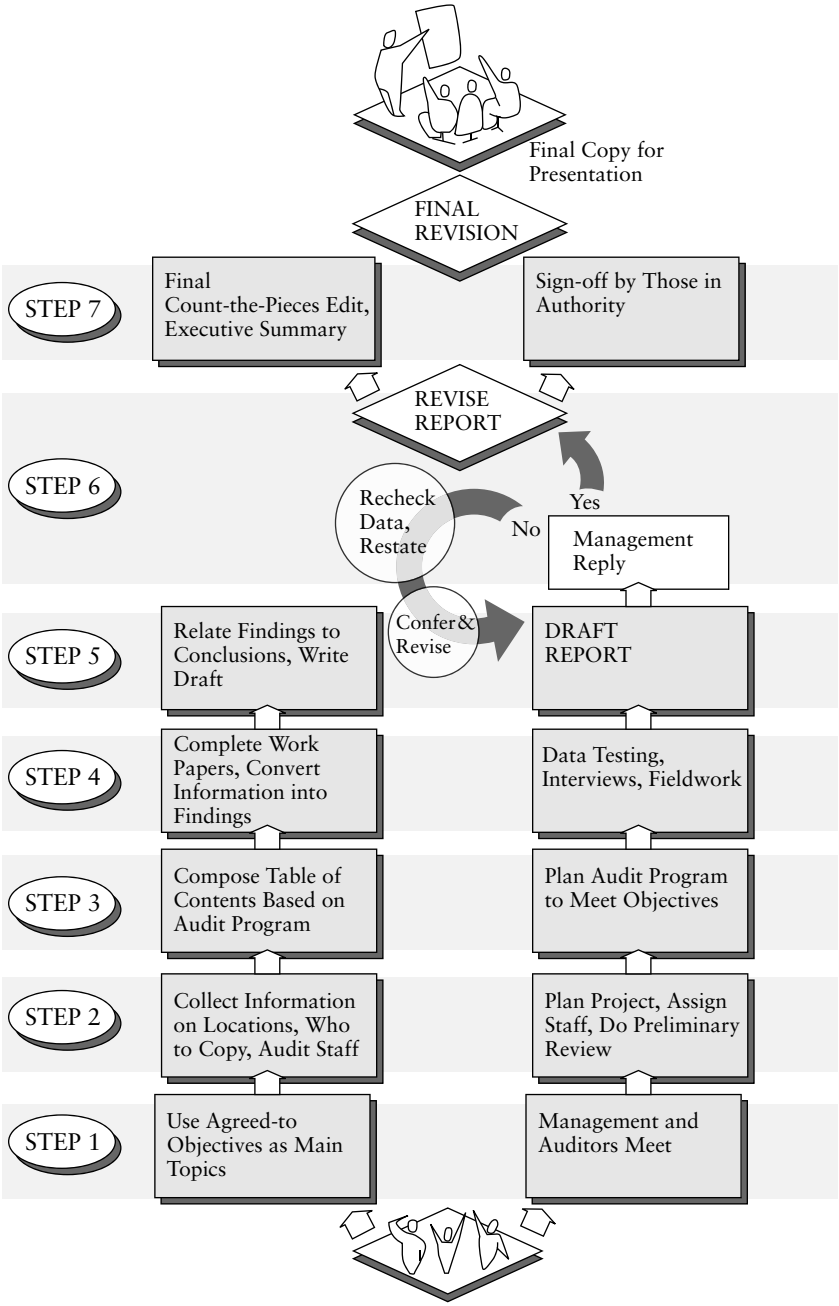
EXHIBIT 1.2 *Report Writing Process*



company—as opposed to just the information itself, has not been valued in the business world until recently.

Tracing the progress of information from controls testing to conclusion in an audit report was not as crucial either—until pointing out the relationship between such elements as missing files and overstated earnings became critical. This need for closer, connect-the-dots risk assessment was mandated by SOX, but for many companies, process-driven reporting has been in place for some time.

EXHIBIT 1.3 *Comprehensive Audit Reporting Process*



Any process is simply a methodology made up of continuing developments or iterations—a particular way of doing something comprising different steps. Subsequent steps depend on what occurred in the preceding steps. Therefore, noticing what happens, responding to changes, and articulating the progression between the steps is critical. Vivek Ranadive talks about "event-driven companies" that "manage by exception."[1] In these organizations, changes are noticed and responded to—in real time. Such organizations possess "the technical structure to deliver integrated, real-time, active information and the human culture to transform information into knowledge and then into informed, ongoing action."[2] An internal audit report does that too: transforms information into knowledge and, by means of the recommendations, into informed, ongoing action.

Process-driven reporting also depends on—and SOX requires—collaboration. Audit professionals in any company who rarely communicate directly with each other (anyone who sends e-mails to the next cubicle, tune in on this one!) can lose perspective about what is happening in terms of financial operations or internal controls. But when audit committee members, management, and auditors have the opportunity to discuss issues together, there is less likelihood of distortion in the conclusions, and more opportunity for communicating complete and accurate engagement results.

Computer Sciences Corporation executives commented on post-SOX guidance from the Securities and Exchange Commission (SEC) and Public Company Accounting Oversight Board (PCAOB) saying they hoped it would enable auditors to "realign their audit scope and refocus their procedures." They said: "Moreover, enhanced planning and coordination between issuers and their auditors, as well as acceleration of issuer testing for higher risk areas, should have resulted in improved audit integration, expanded reliance and significantly lower fees."[3]

On the subject of effective planning, the Audit Committee Chair of a national bank insists that internal auditors report to the committee without any filtering by management. He believes in setting the work plan and scope of each audit in conjunction with the internal auditors, be they in-house or outsourced, and characterizes the current audit

reporting climate as one of greater diligence and communication. "Meetings are also much better documented since Sarbanes-Oxley," he said.[4]

From a report-writing perspective, those carefully kept minutes can serve as reliable guideposts for the actual report—preventive rewrite, we might say. In terms of production, this type of process-driven internal audit report is a seamless and logical outgrowth of the audit work instead of an isolated chore. It is easier to write and more satisfying to read.

THE COMPREHENSIVE AUDIT REPORTING PROCESS

An analysis of each of the seven steps in the comprehensive audit reporting process follows. Each step spotlights a particular communication skill, such as listening or linking, but all of the skills are applicable in all of the steps.

Step 1: Listening and Interpreting

The first meeting establishes relationships that will carry through the entire audit; therefore, listening skills are essential. When the expectations for a particular audit are initially stated—via a formal Terms of Reference (TOR) document, a discussion about intended objectives, or a listing of areas of greatest potential risk—it pays to pay attention. Productive listening, sometimes called active listening, means paying such close attention that, with respect to anticipated outcomes and audit objectives, the internal auditor can restate what is being asked following the meeting, and the CAE and audit committee members all agree.

Sometimes internal auditors sit through the formal audit conference and only hear what is said—without really listening. If that sounds like mumbo-jumbo, listen up. Active listeners are open to what the Chief Financial Officer (CFO) or CAE is saying without trying to finish the thoughts themselves or prepare "I got it covered" responses. To put it another way, active listeners tune in to what is being broadcast and get the message loud and clear without creating static by starting to mentally plan their work. They are even taking a few notes that can be used as headings for the report.

LISTENING TIPS AND TECHNIQUES

If you wonder whether you are an active listener, ask yourself these five questions:

1. Do you let speakers finish without interruption?
2. Can you prevent distractions from disrupting your listening?
3. Can you tolerate silence and let the speakers collect their thoughts?
4. Do you notice body language and incorporate it into the message being delivered?
5. Do you ask questions to clarify and amplify what was said?

If you can answer yes to all five questions, congratulations! And keep listening.

Optimum communication will occur when the assigned audit staff can attend even the initial meetings with the audit sponsor. CAEs and managers pass on the best information they have, but any time information is transmitted and distributed among many people, there is a chance that certain nuances of meaning will be lost—or altered.

Interpretations Differ—Be Specific

Every person interprets information differently. Even people working together in the same company who have the same objectives and speak the same language will infer different meanings from the same set of words.

The following data definition mantra is useful for both auditors and Information Technology (IT) people: "To accurately roll up financial data, it is imperative that the data have unambiguous definitions."[5]

In Step 1, many companies use audit request forms of one type or another to pinpoint the scope of the audit or areas of the business to be examined. Categories on a typical audit request form might include

Situation and Reasons for Project, Description of Project and Objectives, and Work and Final Products Requested. Other report headings might be even more direct: the Existing Situation, the Should-Be Condition, and the Effects on Costs and Performance. One post-SOX report format simply includes Project Scope and Objectives, Executive Summary, and Opportunities for Improvement.

Whichever set of categories is selected, being as specific as possible at this stage of the process sets an important precedent, one that will pay off later. Immediacy carries energy. The words used to describe a tricky issue, such as valuation of fixed assets, when that issue is first brought forward are likely to be used later. To avoid getting stuck with abstract generalities then, write down exactly what is said using quantifiable terms—in real time.

An agreed-upon audit plan also provides the necessary elements for the report's Table of Contents (TOC), and the TOC can then serve as a reference point for determining essential information throughout the course of the audit.

Step 2: Collaborating on Audit Components

Since SOX, making collaborative decisions about the audit plan is not only beneficial, but necessary. Step 2, which involves assigning the audit team, planning fieldwork, determining the distribution list, and other administrative specifics, is an excellent place to practice collaboration skills.

Collaboration is important at all stages of the process, but most especially, when the groundwork for the audit is being established. Internal auditors should make a point of conferring with their CAE, audit committee, and managers together. That way, hot topics such as revenue recognition can be clarified, and any other potentially ambiguous terms can be defined before they appear in a report that then requires too many revisions.

Any relevant background—not all the background, just what is required—can be researched and written up during this step, such as the

name of the entity and description of the business, the purpose of the audit, and what the areas of concentration (read "highest risk") should be.

An understanding of the business—and the businesspeople—being audited cannot be underestimated. Auditors may be so intent on strictly following professional guidelines that they, justifiably, omit reviewing a procedure such as payroll and expenses (P&E), but if the CEO wants to know those details, the P&E audit stays in the picture.

Knowing what the audience wants, what all the audiences want, is essential. As more and more auditing work is outsourced, conducting a little informal market research to determine what is desired is critical. Ask the audit committee what they want.

Sometimes asking for what we want is not as easy as it sounds. We have all attended luncheons where the salt or the salad dressing is across the table, and the person seated there is engaged in conversation with somebody important. When it comes to setting the parameters for an audit, do not hesitate to ask for the salt. Information about how to effectively probe is contained in Chapter 5.

The Components

Many internal audit departments are revising the classic five audit components, whittling them down to three or four, or shifting the emphasis to risk-related components. The Institute of Internal Auditors (IIA) does not specify five required components, but, with respect to disclosing noncompliance, the performance standard is as follows:

> When noncompliance with the Standards impacts a specific engagement, communication of the results should disclose the Standard(s) with which full compliance was not achieved, Reasons for noncompliance, and Impact of noncompliance on the engagement.[6]

Standards, Reasons, and Impact are comparable to the classic components of Criteria, Causes, and Effects. The traditional five are listed in Exhibit 1.4.

EXHIBIT 1.4 *The Traditional Five Components*

Conditions: Problems or opportunities—plus evidence

Criteria: Applicable standards, policies, or procedures

Causes: Conditions, circumstances, practices, or fundamental weaknesses that allowed the conditions to occur

Effects: Cost, exposure, risk, or timeliness issues that are actual or potential effects of what was observed

Recommendations: What needs to be done to fix the problems and what the benefits will be

Step 3: Deciding Core Issues

Deciding the core issues to be covered in a particular audit is another step where listening and collaboration skills add value. In this third step, the fieldwork outline is refined into a precisely orchestrated program that will meet audit objectives. Management may have requested a review of X, but the auditors, who have been noticing Y, should suggest that the scope be enlarged to accommodate the latest data. This step should always be left open for new data and circumstances that arise.

Whether auditing traditional areas such as financial due diligence or conducting a formal SOX audit of internal controls and risk, internal auditors need to deepen their focus. Completing a checklist of line items for review is not enough; questions need to be asked regarding what matters in this specific situation, in this particular company. The IIA says: "Internal auditors should conduct a preliminary assessment of the risks relevant to the activity under review. Engagement objectives should reflect the results of this assessment."[7]

Deciding what matters, like deciding what to say, is essential in telling any story—and "story" here does not mean something that is not true. Story, in the context of business reporting, means getting the point across logically—without gaps—in a way that engages readers and makes meanings easier to grasp.

Like any good story, internal audit reports contain all the necessary narrative elements—findings to be acknowledged, recommendations to be dealt with, potential risks to be avoided, heroes and heroines, and an ending that promises sustainability and profitability. (Have the video game people gotten hold of this concept yet?) Positive endings are, naturally, what most financial executives are interested in; therefore, smart internal auditors start focusing on their conclusions from the beginning.

Current Criteria for Risk

Deciding what to say with regard to potential risk issues involves looking at a range of different criteria. What was once merely a matter of dollars—anything over a predetermined amount was material and therefore important—has become far more complex. For example, Michael Ramos distinguishes "design deficiencies" from "operating deficiencies," and notes that the SEC contrasts "significant deficiencies" (same as "reportable conditions" per the American Institute of Certified Public Accountants, AICPA) and "material weaknesses." The terms "likelihood" and "significance" must also be considered when deciding whether to include a finding of potential risk.[8]

Continual, and often undocumented, upgrades in IT technology, are also adding new criteria for the decision about what to say. Internal auditors are used to analyzing inventories and receivables, reviewing payrolls and personnel, and, more and more, understanding how the IT software works. Therefore, the connection can be made between how company activities are accounted for and what the probable outcome of those activities will be. At this step, the focus should be on information that will make it easiest for management to understand what actions must be taken to prevent fraud and protect against risk.

Step 4: Essentials versus Nonessentials

The main complaint audit directors and managers make about internal audit reports is that the auditors include too much information (TMI). The cry of TMI needs to be taken seriously! True, internal auditors

examine a high volume of data, and it can be difficult to disengage from facts and figures that are fascinating, that necessitated time-consuming efforts, and that seem relevant at first analysis.

A truism regarding any kind of writing is: "You can't say everything without ending up saying nothing." Saying more than is necessary is generally more of a problem in internal audit report writing than withholding information.

Along with questions about structure, auditors with whom I have worked ask most often about how much information to include. Professor Richard Brody emphasizes the importance of focusing on the big picture and not getting bogged down in the details. He says: "From an IA perspective, any kind of problem may be worth noting. But situation-based decisions need to be made about the significance of each. The question to ask is: which issues are significant enough to bring up to the client? Then talk to the client and reach agreement that those are the areas that should be included. And, don't wait till the end of the job to communicate weaknesses."[9]

Successful internal auditors communicate with the managers upfront and get to know and understand the nature of their business and what their concerns are. Then, in addition to complying with IIA professional standards—and SOX requirements, if applicable—they report the specific conditions, causes, and recommendations that the decision makers and implementers need to know.

Suppose an operations audit requires a month-long study of inventory procedures and reveals more than 300 different discrepancies. Each has a unique set of circumstances, and one-third of them approach substantial materiality levels. To include all 300 cases in the report is tempting—a nice list in an embedded table at the end, perhaps? Especially when at least half of the cases required hours of high-level detective work and analysis to uncover. But all management really needs to know is that the software needs tweaking because an aggregate of X dollars is in question. A statement summarizing the situation that references the 300 cases and significant percentages will get the auditors the credit they deserve without drowning the managers in data.

Auditors do valuable work; however, reports are not the place to exhibit *all* of that work. Paradoxically, fewer words and lower page counts are what make reports value-added.

Different Foci for Different Folks

Different audits naturally call for different points of emphasis. The main message for a postacquisition report, for example, is whether the acquisition price was worth it—with specific references to the success of the integration of the new entity, whether projections were realistic and whether they were met, and whether sufficient legal, financial, and technical due diligence was carried out. For a routine financial report, the sponsors might be asked whether any unusual circumstances or anomalous events should be given special attention with regard to significant internal control issues. If the report is more of a management evaluation, then the main message should synthesize the overall functioning of the company—with specific examples. And for the newly mandated SOX reports, the theme is generally one of ranking observed and potential risks and connecting them to recommendations with clearly spelled-out consequences. All of the audit team members should keep an index card with the main message next to their computers and refer to it as they decide what to include in the report.

Series of Selections

Once the primary message decisions are made and agreed on, a series of judicious selections based on those messages is required.

On the macro level, if the internal auditor has not synthesized the major message of the report into two or three sentences, he or she will have a hard time producing a coherent report that can be summarized in a couple of pages and will most likely enumerate conditions and situations that are not relevant to the audit objective, and will utilize unnecessary words, draw unclear conclusions, and write run-on sentences—like this one! Managers who have to read such a report will have numerous questions and will want to make lots of changes.

Conversely, when auditors neatly sum up the message, they can then relate all supporting data to that message and write a conclusion that reinforces the message and their solid thinking—and satisfies SOX and every other professional standard. Professionals are valued for how they think more than for what they know. No matter how interested people are in a subject, the twenty-first-century business world of high volumes and low attention spans does not allow time for everything. Anyone who tries to say it all says nothing.

To those internal auditors who have managers or audit sponsors who *do* want to see it all: appendices and other extra-vehicular modules are the key. Tips on how to package information for detail-demanding readers are included in Chapter 9.

Create Categories

After compiling field notes and selecting the most effective supporting details from among all the data, create categories and subheadings based on those selections. It is not enough to list a series of discrepancies or misstatements or merely point out that X files are improperly controlled or supervised. A synthesizing statement about the condition that is indicated by those facts should be made.

Step 5: Linking and Synthesis Thinking

This is the step where a collection of data is transformed into a report, where what the auditors have been thinking gets expressed on the page. This is also where the communication skill of linking, or synthesis thinking, is used to relate the findings to the conclusions and to articulate the recommendations.

Categorized as a higher-order thinking skill (HOTS), synthesis thinking may be the only aspect of auditing that will not eventually be automated or outsourced. Synthesis thinking can be defined as the ability (1) to see patterns, organize parts, and identify components; (2) to generalize from given facts, relate knowledge from several areas, and draw

conclusions; and (3) to compare and discriminate between ideas, make choices based on reasoned arguments, and verify the value of evidence.[10]

As auditors assemble data for a report, they are already engaged in the process of filing the information in their own internal computers. At the same time, they are noticing the relationships between the different data sets that are being filed. Linking, therefore, begins the moment the auditor walks into the audit site. As facts are gathered and aggregated, the thinking that accompanies those tasks is not only linear—that is, related to organizing the data for future reference—but the HOTS are also analytical and synthesizing. This thinking includes asking questions such as: How significant are these missing authorization signatures to overall internal controls? Is a lack of segregation of duties in this instance material to company operations? How does this tie to what the CEO and Audit Committee need to know?

Audit Committee Chair, Board Member, and BBI Group executive Bill Stevens says that since 2002, audit committees are required to be more rigorous in everything they do. "The committees are spending more time—the meetings are longer, there are more people in them, and more work is done between meetings," he said. "Being vigilant and staying on top of all financial operations, including internal controls, is an ongoing process."[11] But ultimately, the audit committee members only need to know the implications of all those inconsistent data entries; they should not have to read every one of them.

Changing Direction at Report Time

For the internal auditor, conclusions and recommendations are based on observed data, and the process is inductive, meaning it moves from amassing discrete items to a general summation. However, the written report requires the opposite approach. The team needs to change field direction, so to speak, when it comes time to structure a report that addresses the needs of the executive readers.

As opposed to the inductive method exemplified in the data-gathering part of the process, data synthesis calls for a deductive approach. The

report should proceed from the conclusion, or general statement of the main message, to particular supporting data, including only as much of the latter as is absolutely necessary.

For example, if, after files are collected, reviewed, and analyzed, more than half are found to have been improperly handled, the conclusion is drawn that improved controls are needed. The written report would begin by stating that improved controls are needed, and then proceed to explain the basis of that recommendation. References to observed data can be arranged in MS Excel spreadsheets and charts of various kinds to make accessing the supporting data easier. The point is: Effective reports do not lead off with a list of specific instances in which controls were lacking. Executives and audit committees want to know what they need to take action on, and then they want to know the details.

Linking and Synthesis Thinking

Linking and synthesis thinking make it easier to reverse the particular-to-general audit logic flow and to connect the dots the way the report readers expect them to appear—general to particular. Furthermore, applying the skill of linking (PricewaterhouseCoopers calls it *connected-thinking*)[12] results in a document that CFOs and Audit Committees can (1) read quickly, (2) immediately relate to, and (3) trust to keep them fully informed.

Step 6: Rewrites and When to Quit

Step 6, identical in both the report writing process and the audit process, is usually composed of several iterations, because this step involves getting approvals on the wording of the document.

Even when people agree on the content, the temptation to change, alter, revise, improve, rewrite (you get the idea) another person's copy is irresistible. The first draft may not be in line with what management expected, conditions may have changed since the audit began, new information may have recently become available, or new management

may have come on the scene. For whatever reason, this step usually takes some time, because revisions then need to be reviewed. And only when all are in agreement can the document be sent on to the final step. But these discussions and revisions are actually good for the final product; they add value. Invariably, either new information or a new take on the old information are brought forward during this part of the process.

All Good Writing Involves Rewriting

Furthermore, it is impossible to write a complete and satisfying report in one draft; professional writers would not even consider it. The craft of writing is actually rewriting. So, schedule time for the discussions, listen up, and enjoy the collaborative process.

One caveat: The tendency of some managers to overedit should be curbed—with or without enthusiasm. Ask those who edit to focus on finding factual inaccuracy rather than picking apart prepositional phrasing or punctuation, but get to know who is a stickler for what kind of wording—and act accordingly. Understand that most people, when asked to read a draft of any document, believe they have not done their job unless they find an error. Leaving in a few immaterial misspellings can often assuage that editorial need to locate something.

Step 7: Executive Summaries

The draft is approved, and the report is ready to go into production. Right? What about an Executive Summary? Paradoxically again, these summaries have gained in importance as they have decreased in length.

Most internal audit reports need an executive summary; having a shortened version of anything longer than 10 pages is insurance that the message will be delivered. For instance, one multinational company requires its internal auditors to write reports no longer than 20 pages, with a 2-page executive summary. In the case of the generally shorter SOX reports, however, readers are more likely to read the entire report.

Executive summaries can be written earlier in the process, but chances are that final, approved information will only be available at Step 7. In Audit Standard 3 on Audit Documentation, the PCAOB notes that: "Conclusions reached early on during an audit may be based on incomplete information or an incorrect understanding."[13] All the more reason to review, rethink, and revise.

As the summary is prepared, editing for consistency and overall appearance can take place. Comprehensive tips and techniques on editing are contained in Chapter 9, but the most important are to count the pieces, match the titles, make it look good, and read it aloud.

The results of this seven-step process? The final copy of the report is ready for presentation, distribution, and the permanent record. Not, we hope, for the evening news.

Notes

1. Vivek Ranadive, *The Power of Now* (New York: McGraw-Hill, 1999).
2. Ibid.
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4. Irv Diamond, Audit Committee Chair, telephone interview, March 2006.
5. Gwen Thomas, "SOX and the Database Professional: Mainframe Compliance Issues," *z/Journal,* October/November 2005.
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8. Michael Ramos, *How to Comply with Sarbanes-Oxley Section 404: Assessing the Effectiveness of Internal Control* (Hoboken, NJ: John Wiley & Sons, 2004).
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13. Public Company Accounting Oversight Board, Auditing Standard No. 3, Section 32.