International Operational Auditing

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IIA Chicago Chapter 53rd Annual Seminar
Monday, April 15, 2013
What We Plan to Cover

- Learning about the differences in auditing international, versus domestic locations and some of the key issues to look for
- Expanding understanding of different cultures and business practices around the globe
- Discussing experiences that highlight the best practices for successfully executing audits in foreign countries
Auditing Companies with International Operations
Why Companies Do Business Overseas

Important to understand why overseas operations exist to assess the risks

Access to Growing Markets
Economic growth forecasts show strong growth in BRIC Countries

Access to Supplier Networks

Manufacturing Overseas
Labor Cost Savings
Flexibility

• What objectives does your company have for operating overseas?
• What risks relate to these objectives?
Differences between auditing domestically and internationally

- Different set of risks
- Different Accounting Rules
- Logistics
- Language
- Culture
Key Risks facing Companies Operating Overseas

- Regulatory and Tax Compliance risks
- Intellectual Property
- Fraud and Corruption Risks
- HR Risks
- Different Business Practices
- Accounting and Information Systems
- Total Landed Cost
- Global Supply Chains
Regulatory and Tax Compliance Risks

**Employment laws**
- Can be complex and can lead to fines and litigation
- Rules on overtime, rest periods, and employee contracts

**Tax compliance**
- May be numerous overlapping taxing jurisdictions
- VAT laws can be complex

**Transfer pricing**
- Increase in transfer pricing audits
- Reviews of local transfer documentation requirements and pricing

**Repatriation of funds**
- Rules on dividends, fees, interest and royalties

**Data privacy**
- Local regulations regarding PII
- EU is particularly restrictive
Audit Considerations: Regulatory and Compliance Risks

- Work with Compliance, Legal and Tax Functions, Local or regional Management;
  - Understand relevant regulations and compliance processes

- Determine if there is a clear understanding of relevant regulations, and a process to comply
  - If not, this is a significant audit finding
  - If there is, can audit the compliance process

- Ask if there have been any inquiries from regulators or regulatory actions
  - Look for fines and penalties on books

- Review tax filings and reporting requirements:
  - Are all filings on time?
  - Any penalties?
Companies doing business globally need to think carefully about their data and IP security – how information is shared, who has access to what, what information needs to be protected, and how.
Audit Considerations: IP and Data Security

Understand what IP exists
- Who uses it and who has access

Understand Flow of Data
- Sources and uses of data

Understand Local regulations
- Each country may have its own data security regulations

Consider penetration testing
Fraud and Corruption Risk

BRIC Countries generally present high corruption risk

FCPA:
- Prohibits bribing of government officials

Enforcing the FCPA is a continuing priority at the DOJ and the SEC

Areas of exposure:
- Third Parties
- Travel, entertainment and gifts

International Anti-Corruption Efforts:
- OECD Working Group on Bribery and the Anti-Bribery Convention
- UK Anti-Bribery Law
Considerations for Auditing Fraud and FCPA

Policy
• Is there an anti-corruption policy?

Customers
• What is the relationship of your customers with the government?

Training
• Are sales and other “front-line” personnel trained

Interviews
• Talk to sales and other personnel to see if there are any indications of fraud or corruption

Vendors
• Who are the key vendors and what are they used for?

T&E
• Consider auditing entertainment and gifts
HR Risks

BRIC Countries
- Corruption and opaque government policies and regulations
- High risks in employing people in these locations arise due to the lack of clarity and inconsistencies in employment regulations – Russia is the highest risk
- Nationalism favors local firms
- Contentious and politicized labor relations

Hiring
- Shortage of qualified employees in China
- Salaries have increased dramatically in China – 28% last year

Turnover and Retention
- Increase in naked resignations in China
- Chinese turnover rate is 19% (versus 5% in Western countries)
- India's IT and financial services industries are also facing high attrition rates

Talent development
- Improving in India and China
Different Business Practices

Billing and Collecting
- Payment terms are often extended
- Strict billing practices – high level of documentation requirements

Personal relationships
- Need for personal interaction
Accounting and Information Systems

US GAAP
- Local Books may be on a statutory basis
- Knowledge of US GAAP likely to be limited

Revenue Recognition
- Understand Revenue Recognition Rules and how they are applied locally

Information systems
- Lack of integration
- Inadequate local systems
- Availability of data
Accounting and Information Systems - Considerations

• Questions to ask:
  – Are two (or more) sets of books maintained?
    • Are these separate systems or the same system?
    • Is the local entity on the company’s system using the same chart of accounts?
    • What is the process for posting and reconciling between the sets of books?
    • What is the process for adjusting to GAAP basis?
  – Are all statutory filings up to date?
    • Any issues or adjustments?

• Consider test revenue recognition, system controls
Global Supply Chain Risks

Companies depend on globally interconnected supply chains

- Trend of deepening and broadening supply chains
- Technological specialization: global dominance by a small number of specialized, niche suppliers
- Use of unique raw materials creates sourcing risks
- Offshoring of R&D and outsourcing of manufacturing

Third Party Risk Management

- Strikes, child labor, conflict minerals
- Supply Chain Continuity:
  - Major concern due to natural disasters, geopolitical upheaval and supplier capabilities
  - One “weak link” in the chain can cause supply disruptions

Demand and Economic Volatility

- Lead times can be extended with global supply chains
- Managing lead times again became a major issue
Logistics, Language and Culture
Logistics – Considerations

Visa
• Be sure to allow adequate time for obtaining a visa from the country you are auditing - can be as much as 6 or more weeks
• May need to also obtain letters explaining why you’re visiting

Travel Time and Expense
• Travel time and expense can be significant
• International hotels and restaurants in business districts are expensive
• Jet lag impacts productivity
• Working in different time zones

Holiday Schedules and Work Hours
• Understand local holidays and work schedules
• Europe Summer Holidays

Coordination
• Coordinate well ahead of time
• Take into account time zones – often means late night or very early calls
Language and Culture

Language
- Most of the documents you will plan to review will not be in English
- May not be able to interview local personnel in English
- Communication
  - Use simple, clear concise communication
  - Don’t assume understanding

Asian Countries
- Commonly viewed by westerners as “opaque”
- Concept of “face” is very important
- Highly collectivist society with relatively strict gender roles
- Indirect communication
- Hierarchy is very important

Europe:
- Be aware of cultural expectations – generally more formal and focused on credentials
- Very low corruption in many countries, i.e. Finland
- Quality of life

Latin America
- Similar to Asia in many ways
- Hierarchal, loyal, indirect communication
- Formal dress, distinct gender roles
- Tend to be warmer and more emotional, highly religious

Understanding the cultural differences can help build effective relationships with overseas operations
Discussion

• Issues and experiences
• Best Practices