Internal Audit Function’s Job Rotation Program: Effect on Regulatory Compliance

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Job rotation programs are implemented by many companies in their internal audit function to provide opportunities for internal audit staff. By rotating staff into different functions for a period of two or three years, the process can help obtain better understanding of the business. When companies are facing major regulatory compliance changes, internal audit becomes a key resource and rotation has new meaning in related area. By rotating staff into different job functions, the organization can gain more benefits such as promoting an ethical culture by utilizing internal audit function’s role of ethics advocate.

a. Discuss what internal auditors’ role in regulatory compliance is by implementing a rotation program.
b. How can rotation better contribute to regulatory compliance?
c. What would be the downside of rotation assignments?”

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ABSTRACT:

The purpose of this paper is to discuss the underlying relationship between the rotation programs implemented by companies for their Internal Audit functions and the dynamic regulatory compliance changes. The subject matter examines the role of an internal auditor in regulatory compliance once job rotation program is executed in an organization. This paper is also intended to provide a discussion on how better can rotation contribute to regulatory compliance and on the other hand what would be the shortcomings of implementing such a program.
INTRODUCTION:

Without any question, today organizations face challenges such as globalization, uncertain market conditions, compliance to ever-changing regulatory requirements, diversity, innovation, information overload and technological advancements, just to name a few. Therefore, it becomes integral on the part of management, board of directors and executives throughout the organization to respond to these changes timely and effectively, before they pose a threat to the business processes. Internal audit function helps to adequately address these changes on an ongoing basis and put proper controls to mitigate risk to an acceptable level. Internal audit is an independent management function, which involves a continuous and critical evaluation and assessment of the functioning of an organization with a view to suggest improvements thereto and add value to and strengthen the overall governance mechanism of the organization, including the organization’s strategic risk management and internal control system.

As business processes become more complicated, information more widely obtainable, and the corporate world in general more sophisticated, the need for the internal audit profession to adapt to this new environment becomes evident and thus Internal audit work has evolved more into risk-based rather than only transaction-based. To manage this change, internal auditors must continuously enhance their skills, educate themselves on new technologies and competencies that will be required in future years to come and add value to the organization. And having an effective and efficient internal audit team is critical for the growth and development of any business and therefore comes the question for a proper “staffing-mix”.

Proper Staffing is imperative to the internal audit function because as the role of internal auditor evolves, audit requires such competencies that exceed the traditional technical skills and align with the business objective. The Securities & Exchange Commission (SEC) requires it for all the companies listed on NYSE to maintain an internal audit function and must team with and have excellent relationship with management and the support from audit committee with ongoing assessments of the company’s risk management processes and system of internal control. Recently SEC also proposed rules for companies listed on NASDAQ Stock Market LLC to maintain an Internal Audit function to help management and audit committee with ongoing assessment of an organization’s risk management process and internal control system.

With the passage of time and with more recent frauds, scandals or failures such as Enron, WorldCom and Madoff, resulted in more rigid regulations to adhere to by a company known as - U.S. Sarbanes-Oxley (SOX) Act of 2002. Other frauds that led to similar types of laws and regulations are The Health Insurance Portability and Accountability Act (HIPAA) of 1996, Dodd-Frank act of 2010 and Gramm–Leach–Bliley Act (GLB) to name few. As new regulations surround the audit profession, the knowledge of these regulations on a timely basis to internal auditors is essential.

In order to have the right staffing mix and constantly assessing skills and managing talent, has always been a challenge for companies as well as Chief Audit Executives, and to cope with inadequate staffing companies employ Job Rotation Programs. This helps in filling the gap between what skill internal audit team possesses now and what potential talent will be required to respond to myriad of emerging issues in future.
JOB ROTATION PROGRAM:

There are several definitions and designs to Job Rotation Program and is viewed upon differently by different businesses depending on their objectives and needs. Job Rotation is an approach to management development where an individual is moved through a schedule of assignments designed to give him or her a breath of exposure to the entire operation. Job rotation is also practiced to allow qualified employees to gain more insights into the processes of a company and to increase job satisfaction through job variation. The purpose is to give the employee a bit of a break and hopefully increase job satisfaction and motivation. Position rotation occurs when an employee is moved to different positions, departments or geographic locations as a means to increase an employee's knowledge, skills and perspective. It is often used as a means to groom an employee for future leadership positions within the organization.

Internal audit staff should also have the requisite collective skill levels to audit all areas of the institution. Therefore, auditors should have a wide range of business knowledge, demonstrated through years of audit and industry-specific experience, educational background, professional certifications, training programs, committee participation, professional associations, and job rotational assignments. Internal audit should assign staff to audit assignments based on areas of expertise and, when feasible, rotate staff within the audit function.

Internal audit management should perform knowledge gap assessments at least annually to evaluate whether current staff members have the knowledge and skills commensurate with the institution's strategy and operations. Management feedback surveys and internal or external quality assurance findings are useful tools to identify and assess knowledge gaps. Any identified knowledge gaps should be filled and may be addressed through targeted staff hires, training, business line rotation programs, and outsourcing arrangements. The internal audit function should have an effective training program to advance professional development and should have a process to evaluate and monitor the quality and appropriateness of training provided to each auditor.

Types of Rotational Programs:

Rotational Programs can help Internal audit accomplish a number of objectives, but to ascertain a beneficial and the best rotational program is what a company should determine. For instance, one of the CEB Blogs published a research on different types of Audit Rotational Program.

- **Inbound:** Employees from the business rotate into Internal Audit for a specified time, after which the employees rotate back into the business.

- **Outbound:** Internal audit staffs rotate out to the business for a specified time, after which they rotate back into the internal audit department.

- **Guest Auditor:** Employees from the business participate in a single audit engagement or a short series of engagements, after which they return to their normal position.

- **Leadership:** External candidates are hired into the audit department and then placed out in the business after a specified period of time.
This is not an exhaustive list but these could be implemented in an organization after considering the factors affecting the company such as, size of the company and audit department, scope of work conducted, training and development infrastructure and also the company’s culture.

**Auditor rotation program** provides opportunities for auditors to rotate though other positions within other business units or functions in other parts of the organization, while **Guest auditor program** provides an opportunity for high-performing employees from other parts of the business to gain internal audit experience, providing the function with specialized skills that may reside in other functions or business units.

For instance, a job rotation program design at General Electric (GE) entails a set of defined-length assignments within the given functional area and one of them is the Internal audit function of GE, that is, the Corporate Audit Staff (CAS). “Employees who join CAS, work for two or more years full time and participate in four-month audits, both financial and process ones. These assignments spread across the globe and cover all the divisions of GE from industrial businesses to the financial services arm of the company. The assignments provide an excellent opportunity and a steep learning curve to gain knowledge about the business as well as the organization. High performance is expected from participants; however, it is also enabled by frequent assessments, feedback and training. Typically CAS graduates take management positions when they move back to the business and keep rising afterwards.”

**JOB ENLARGEMENT AND JOB ENRICHMENT:**

Job Rotation often overlaps and is sometimes integrated with **Job Enlargement** and **Job Enrichment**. Job enrichment is an attempt to motivate employees by giving them the opportunity to use the range of their abilities. It is an idea that was developed by the American psychologist, Frederick Herzberg in the 1950s and can be contrasted to job enlargement, which simply increases the number of tasks without changing the challenge. As such job enrichment has been described as 'vertical loading' of a job where employees are given more responsibility. Thus, an enriched job should ideally contain a range of tasks and challenges of varying difficulties (Physical or Mental), a complete unit of work - a meaningful task and feedback, encouragement and communication. On the other hand, job enlargement is 'horizontal loading' or horizontal integration of tasks but does not change the nature of the task. Job rotation models along with the elements of job enlargement and job enrichment have been used throughout history to rotate executives and employees, and a variety of models are found in the workplace today.

**ADVANTAGES OF ROTATION PROGRAM:**

The Auditing and Accounting profession are moving away from the “Traditional Audit” approach and moving more towards the “Automated Audit” approach and thus requires the need for continuous training programs to educate internal auditors with hands on experience on different organization’s processes and businesses it is into. A properly planned and carried job rotation process plays an essential role in strengthening the position of an organization and helps it deal with uncertain and tentative outer environment. Some of the advantages to list down are:

(i) Helps explore the Hidden Talent:

Job Rotation is designed to expose the internal audit staff to a wider range of operations and different business units in order to assist management and Chief Audit Executive (CAE) in exploring the hidden talent. In the process, they are moved through a variety of assignments so that they can gain awareness about the actual working style of the organization and understand the problems that crop up at every stage in the form of regulations.

(ii) Helps individuals explore their interests and align competencies with requirements:

Individuals are not aware of their interests unless and until their job is rotated or they are exposed to different operations and business units, in that way they can identify what they are good at and what they enjoy doing. They get a chance to explore their interests and hidden potential. Rotation can thus help in alignment of competencies
with requirements. This means directing the resources when and where they are required. It assesses the employees and places them at a place where their skills, competencies and caliber are used to the highest possible extent and thereby adding value to the organization as a whole.

(iii) Motivates to Deal with new challenges, increases satisfaction and decreases attrition rate:

When internal auditors are exposed to different jobs or assigned new tasks, which have different implications from regulation’s perspective, it generates an interest and they try to give their best while effectively dealing with the challenges coming their way. It encourages them to perform better at every stage and prove that they are no less than others. This gives rise to a healthy competition within the organization where everyone wants to perform better than others. This increases their satisfaction level. Such variation in the job reduces the boredom in the form of doing the same task, that is, auditing but now there are new challenges, new regulations to comply with and different business units to address. Moreover, it decreases attrition rate and a sense of belongingness towards the organization develops. Job rotation could be introduced to limit a build-up of mental and physical fatigue.

IMPLEMENTING JOB ROTATION PROGRAMS AND REGULATORY COMPLIANCE:

Who are the Regulators?

Today there are federal regulators and state regulators. Some of these regulatory agencies include the SEC, FDIC, CFTC (Commodities Futures Trading Commission), Federal Reserve, OCC (Office of the Comptroller of the Currency), OTS (Office of Thrift Supervision), NCUA (National Credit Union Administration), SIPC (Securities Investment Protection Corporation), HUD (U.S. Department of Housing and Urban Development), Comptroller of the United States, and the U.S. Department of Labor, among others. In addition there are state regulators, including the regulators over banking and insurance, as well as attorneys general, and state controllers. FINRA (Financial Industry Regulatory Authority) is a regulatory agency established by New York Stock Exchange and NASDAQ Stock Market to monitor enforcement of exchange rules and regulations.

What is regulatory compliance?

Regulatory Compliance is an organization’s adherence to laws, regulations, guidelines and specifications relevant to its business. Violations of regulatory compliance regulations often result in legal punishment, including federal fines. Examples of regulatory compliance laws and regulations include the Dodd-Frank Act, Payment Card Industry Data Security Standard (PCI DSS), Health Insurance Portability and Accountability Act (HIPAA), the Federal Information Security Management Act (FISMA) and the Sarbanes-Oxley Act (SOX). As the number of rules has increased since the turn of the century, regulatory compliance has become more prominent in a variety of organizations. The trend has even led to the creation of corporate, chief and regulatory compliance officer positions to hire employees whose sole focus is to make sure the organization conforms to stringent, complex legal mandates.

Compliance Framework

A compliance framework of an organization outlines the regulatory compliance standards relevant to the organization and the business processes and internal controls an organization has in place to adhere to these standards. Such a framework can include communication processes, risk controls and governance practices for maintaining compliance. The framework should also specify which compliance processes overlap to help eliminate redundancies. Therefore, come more and more responsibilities on the part of internal audit function and the people responsible for it.

The objectives of the internal auditor are to obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations generally recognized to have a direct effect on the determination of
material amounts and disclosures in the financial statements, to perform specified audit procedures to help identify instances of noncompliance with other laws and regulations that may have a significant impact on the functioning of the entity and to respond appropriately to non–compliance or suspected non–compliance with laws and regulations identified during the internal audit. Job rotation of internal auditors therefore plays an integral role in regulatory compliance and enhances general knowledge of the business and different business processes bringing more knowledge of regulations that the business has to comply with. Since regulatory compliance is primarily for mitigating risk to the people (HIPAA, GLBA), systemic considerations (Dodd-Frank), investors (Sarbanes-Oxley), and other considerations for the society in general, job rotation inculcates sense of higher level of ethical considerations.

**Integrated Audit:**

Internal Audit is pulled in many directions as expectations increase each and every year. There should be better integration between IT and Financial Internal Audit team members to increase the value and effectiveness. Job rotation prepares an auditor for the “Integrated Audit”. An integrated audit considers information technology, financial and operational controls as mutually dependent for establishing an effective and efficient internal control environment and hence the risk is considered to the business process and includes the knowledge of regulatory compliance. Job rotation along with the “integrated audit approach” will help internal auditors to have a pool of knowledge of financial audit, information technology audit, fraud and forensic audit and tax compliance audit in various processes that the business operates in. Thus it would help the auditors to switch to different job functions for a period of two – three years and gain skill and professional expertise of the work as well as an idea of regulatory compliance in that area. Job rotation prepares auditor for aligning business controls effectiveness with regulatory compliance so that risk mitigation to business can be the positive side effect of regulatory compliance.

In a 10-Step Framework issued by PWC states, “to avoid delays and to get the perfect blend of knowledge and talent pool of internal auditors, third party is considered to provide interim internal audit resources as needed. Through an outsourcing relationship, management and the audit committee are able to focus on hiring the right people while simultaneously delivering results. As staff are recruited and hired, the outsourcing relationship can be scaled to a cosourcing relationship or eliminated.” In the outsourcing of the skilled staff and internal auditors, Protivity, has emerged as one of the large organization.

**Current Ideology:**

The existing regulatory structure is changing rapidly and dramatically as we come across different frauds and scandals, and regulatory bodies are making sure to do everything they can do in this regard. After Enron came to an end and SOX act emerged due to this fraud, it has become evident for the internal auditors to make sure that the company is abiding by the rules and regulations brought forward by this act and therefore a continuous job rotation is necessary. This is an exciting time to be in the profession. Whether we talk about industry, government, or work with a public accounting firm, change is happening all around us. Changes in standards, rules and regulations are coming our way. One thing to know is that the standards used today will be changing, some of them will change in the next year, others may still be in place for a year, two, three, maybe even 5 years from now. The bar is continuing to be raised. The information needed to know keeps expanding. Use of technology will continue to expand by companies and clients as well as by auditors and thus to survive these regulations, an effective and efficient training program is required for internal auditors to fulfill the needs of the changes in the business and its environment in the form of regulations imposed by the governing bodies. The public is looking for real time auditing, predictive information, and is looking to the auditors to protect them, thus quality work is needed.


**DOWNSIDE OF ROTATIONAL PROGRAMS:**

The development of expertise in specific areas of competence is determinant for the Company's success. Therefore job rotation should be practiced with caution. Whilst job rotation might be useful under certain circumstances, it should not result in weakening our expertise in key areas. Therefore the first downside of a rotational program is that the knowledge is diluted by not gaining expertise in one area. There is a concern that the loss of continuity and audit competence created by mandatory firm rotation may create an even greater risk to audit quality. The issue of rotation as an effective means of safeguarding auditor independence has been debated for many years. Several different groups, including appointed commissions, professional organizations, and academics, have researched and analyzed the issue of auditor's rotation. Both task rotation and position rotation share similar disadvantages. Some efficiency may be lost and there would be decline in productivity potential because employees do not develop proficiencies in specialized tasks as quickly due to rotation.

*Secondly,* Rotation may result in increased use of resources and time because of the support required in having a rotation program. For instance, a problem unique to position rotation is the risk of spending time and resources on employees that are sometimes not worth grooming. An organization can reduce this risk by carefully screening candidates for positional rotation who demonstrate the attributes, skills, and organizational commitment to make the investment worth it and adds value to the organization. Relocation could be the possibility and outcome of a job rotation, which would cost a lot to a firm.

*Thirdly,* talking about the Small businesses and firms, which do not have enough pool of resources to occupy rotational programs for their internal auditors on a regular basis, would pose a threat to the business from the perspective of ever-changing regulations and not abiding to the laws set forth by the regulatory authorities would soon throw them out of business. Without adequate job rotation the quality of the work may be impacted.

*Finally,* in certain "specialty" areas, for instance, Fraud Examination and Forensics and Information Technology auditing there may be a limited number of "specialty" internal auditors available to service. In certain industries there may be limited industry expertise. Also, by applying the rotation requirements more deeply, firms might have a difficult time grooming another internal auditor to both have sufficient knowledge of the industry and the client and have sufficient time remaining prior to rotation of the other internal auditor. Also, it may be noted that applying the proposed rotation requirements to specialty auditors could impact audit quality.
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