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P r o h l á š e n í

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1 Introduction

If a company wants to be successful on the market, the globalization and changing needs bring new challenges into various company's activities. One of it is definitely - Internal Audit. Recently, international trends clearly show the higher demands in the fields of Internal Audit, Corporate Governance, Risk Management, Internal controls, Ethics and Compliance. Many people confuse roles of Controlling, External and Internal Audit. I have chosen my minor specialisation "Internal Audit" and I have decided to write my master thesis in a specific company and its experience with Internal Auditing. And I have the opinion that its added value becomes constantly more and more important as a lot of companies needed to re-evaluate and re-structures its processes and activities during the economic crisis 2008/09.

During my internship at Skanska, I did receive the opportunity to become a part of audit team and conducted three internal audit projects. The main objective of my thesis is to describe the important mill-stones concerning this professional discipline in company's processes such as the theoretical background and practical insight in Internal Audit at Skanska. I tried to find out why it is useful to establish Internal Audit department. Furthermore, to identify what key competences/roles it has or should have in order to successfully full-fill its objectives such as to analyze, monitor, control, describe, recommend, advise, consult and verify the company's activities. As well as I would like to demonstrate on two specific cases IA's roles and competences.

My thesis is divided into two main parts, such as the theoretical and practical part. In theoretical part, I describe brief history of Internal Audit with the special interest on the Czech Republic and Sweden. I mention these two countries as the headquarters of Skanska are found in Sweden and it has a long developed tradition. Then, I concentrate more on IA organization and procedures, IA standards and code of ethics. Furthermore, I concentrate on the methodology used in IA.

In practical part, I focus more on a description of IA process at Skanska. I describe the practical background of this company and later on, I have mentioned two practical cases targeted on audit of one loss project and audit of processes such as Accounts payable and Accounts receivable.

I have also looked at the percentage of companies on the Czech market which has the internal audit department and its number is constantly increasing year by year.

That's why; I believe that Internal Audit has its important role in corporate economics and management of the company. And its role is crucial in company's processes and activities.

2 Internal Audit development

2.1 Historical development of internal audit profession

Looking for the meaning in Latin, the meaning is interpreted as hearing and listening. It proves that the audit profession is very old. The early origin dates back to year around 3500 B.C. originally, the need for it has developed with a trade and later on with the development of commercial organizations. The increasing revenues have resulted in the creation of accountability and control over the wealth. In the early times, the main purpose of first auditors, who were in fact hired by the owners, was to control the property of the owners and as well as to take the responsibility over the property. Furthermore, its role varied according the needs and culture. Firstly, it was very similar to the accounting, as the auditors were responsible for the monitoring a type and quantity of goods obtained in exchange. And as well as to show the differences obtained by the sales. That's why, we can assume that the origin of the professional internal audit and accounting is really the same. Moreover, the role of the audit was wider as the auditor was also responsible for the protection of property as well. Another role was to prevent the losses resulted from a theft.

The name “auditor“ can be also found during Roman empire where there existed, so called Roman quaestor – investigators. These were people working for the government in order to provide the oral reports about a state of treasury. This oral reporting led to the name auditor and at that time s/he was the one who brings all the facts.

In mid- 19th century, the development of large private and public enterprises, especially in the United Kingdom, requested other special forms of audit. Its role was to be an independent accountant. There existed the continuous need for an independency as well as accurate reporting of transactions as there was a growing interdependence among enterprises. They were mainly responsible that the financial statements are accurate.

“Since mid – 19th century, there exists a specialized independent accounting profession. Its focus has changed after the U.S adopted the Act on securities in 1933 and the Act on securities and stock exchange in 1934. These acts were issued in order to increase the responsibility of management for submitting of accurate financial information and thus to increase the emphasis on verification of financial and accounting processes. It has resulted in change of priorities for internal auditors from preventing and detecting the frauds to

examining the managerial and controlling instruments regulating the financial and accounting information."¹

"Management found it impossible to visually observe all of the operating areas in their respective areas of responsibility or to have sufficient personal contact with individuals who directly or indirectly reported to them. In seeking ways to deal with these new problems, management appointed special staff people to review and report on what was happening and to probe for the why. These people came to be known as "internal auditors."

In some organizations, internal auditors were used to check on routine financial and operational activities with a heavy emphasis on compliance, security, and detection of fraud. In others, internal auditors were given higher levels of status and were asked to analyze and appraise more substantive financial and operational activities."²

The expansion of the business led to the necessity that the organizations should not only have the external auditors, but also somebody inside who is working internally for them. As mentioned previously, at the very beginning the internal auditors reviewed the financial situation, searched for signals indicating the perpetration of fraud or errors, and this role has remained internal auditors until the beginning of the last century. Gradually, the role of auditor developed and his original job description now belongs to the external auditors. The need to establish in business an independent control of both accounts, but all other activities, was already before the Second World War II. For the creation of this role speaks the following reasons:

- "Changes in the methods and systems management, the increasing complexity of economic phenomena
- The management of large enterprises have the capacity to deal only the most critical problems
- The powers and duties are increasingly delegated, a subsidiary is responsible for its performance
- Extension of communications."³

The Internal Auditing profession evolved steadily with the progress of management science after World War II. Much of the theory underlying internal auditing is derived from management consulting and public accounting professions.

¹ Dvořáček J.: Interní Audit a kontrola, Praha, C.H. Beck, 2000

² <http://www.theiia.org/theiia/about-the-institute/history-milestones/>

³ Dvořáček, J.: Interní audit a kontrola. Praha: C. H. Beck, 2000.

In 1941, the internal audit was so independent that the small group acting internal auditors established the Institute of Internal Auditors (IIA) in New York.

“John B. Thurston, head of the internal auditing function at the North American Company utility company, was among the first to push vigorously for greater understanding and recognition of the internal audit function. He is credited with being the person most responsible for the creation of The Institute. Thurston was joined in his thinking by Robert B. Milne, general auditor of the Columbia Engineering Corporation, and Victor Z. Brink, a former auditor and Columbia University educator who authored the first major book on internal auditing.

Thurston, Milne, and Brink, acting as an organizing committee, contacted 40 friends and associates from the utilities industries, public accounting firms, and other industries, 25 of whom agreed to participate in forming a new organization for internal auditors. Seventeen individuals attended an organizational meeting on Sept. 23, 1941, at the Williams Club in New York City and agreed to start a new professional organization for internal auditors.”⁴

IIA has developed and represents a professional organization with a global scope which promotes and supports the development of the profession of internal auditing. It represents more than 60 000 experts from more than 100 countries. In Europe, there exists an European Confederation of Institutes of Internal Auditors (ECIIA) created in 1982 and represents 27 countries from Europe, Africa and Asia, and having more than 12 000 internal auditors⁵.

With the implementation in the United States of the Sarbanes-Oxley Act of 2002, the profession's growth accelerated, as many internal auditors possess the skills required to help companies meet the requirements of the law.

2.2 Development of internal audit in the Czech Republic

In the Czech Republic, internal audit has started to dominate more strongly in 90s of 20th century. Since 1993, International Standards for the Professional Practice of Internal Auditing (so-called Red Book) was issued and the internal audit became professionally managed. Furthermore, the development of internal audit is closely linked with the Czech

⁴ <http://www.theiia.org/theiia/about-the-institute/history-milestones/>

⁵ www.ciia.cz

Institute of Internal Auditors (ČIIA), which is very similar to the Chamber of Auditors of the Czech Republic for the external auditors.

Czech Institute of Internal Auditors was established in March 1995 as a professional non-profit organization. Its main mission is to promote and support the development of internal audit in the Czech Republic. It is the national institute of the international institute “The Institute of Internal Auditors Inc. “ And it was also integrated to European Confederation of Institutions of Internal Auditors (ECIIA). It has more than 1 000 members. Its highest body is the Assembly, which meets regularly every year. The activities are managed by the council – represented by the president and the activities are supervised by 3 member audit committee. The membership is in this institution voluntary.

Czech Institute of Internal Auditors provides various services. Such as to:

- Develop and promote a professional framework for internal audit
- Organize CIA exam (Certified Internal Auditor). “It is the only globally accepted certification for internal auditors and remains the standard by which individuals demonstrate their competency and professionalism in the internal auditing field. Candidates leave the program enriched with educational experience, information, and business tools that can be applied immediately in any organization or business environment”⁶. It has four parts. The first and the second part are devoted to the theoretical knowledge and IAS practices. The third part involves the issue of management, quantitative methods and IT systems. In the fourth section, the candidate is tested in accounting, finance and economics. There are other requirements as well such as having at least 3 year of professional experience in internal audit and having at least a bachelor degree
- Organize professional training conferences and seminars
- Evaluate the quality of work for particular departments for Internal Audit within the organizations
- Publish the journal “Internal Auditor“. It is a professional journal issued one a month and provides the latest information and insights about IA practices and other topics
- Sponsor research studies
- Publish useful tools for internal auditors

⁶ <http://www.theiia.org/certification/certified-internal-auditor/>

2.3 Internal Audit survey in the Czech Republic⁷

The research was conducted in 2006 as an initiative of Czech Institute of Internal Auditor (CIIA) and audit and consultant global company PriceWaterhouseCoopers (PwC). And its main objective was to inform about the current trends and problems in IA in various business segments in the Czech Republic. The major findings are as following:

- More than 80 % of respondents⁸ has the internal audit department in the CR, in comparison to 41% in 2003 and 36% in 2001
- Internal audit is subordinate to the board of directors
- 21% has the audit committee
- 75 % confirms that its company respect IIA standards
- 27 % thinks that IA brings a low utility

The survey revealed following major problems in IA departments in the CR:

- *Insufficient independence* – IA reports to management in more than 2/3 of companies
- *Ineffective working processes* – companies do not effectively use the supporting IT systems and there also exists the problems in communication
- *Insufficient quality orientation* – as there was a low number of companies which have the compliance with IIA Standard about quality (such as Standard 1311 and 1312)

⁷ Průzkum trhu Interní Audit 2006, PwC a CIIA

⁸ Current number of respondents is 80 from 400 inquired. These are the companies operating in the CR – 36% represents industrial companies, 28% represents public sector, 19% represents financial services, 9 % represents energy industry and the others

2.4 Internal audit in Sweden

In 1951, a small association was created in order to allow internal auditors to meet and get in touch with each other. Later on, from 1980s, a discussion took place about which direction and objectives should Internal Audit adopt. During the 1990's, risk analysis was included in Internal Audit, as internal audit was officially recognized identity. There was a new law introduced in 1995 in order to control public entities with large capital flows. "In 2002, the Swedish SAI⁹ (Swedish State Audit Institution) found that the position of IA was institutionally weak, many auditors work alone and that the interpretation of standards was not uniform. The government then commissioned an inquiry to gain an overview of all public sector internal audits. This inquiry was delivered at the end of last year. Its recommendations included measures to clarify the responsibility for internal management, control, and audit and to professionalize the state internal audit."⁷

In 2003, the former Auditor-General in cooperation with high level officials, business people and academics created "The Audit Academy" in order to spread a good word about audit agenda in society, academic courses, as well as to improve educational quality, stimulate audit research and elevate the image of the profession to attract students.

In April 2006, there was a law on IA became valid saying that all companies which are publicly traded on stock exchange must have a department for Internal Audit.

In 2008, IIA Sweden signed an Institute Agreement with The Institute of Internal Auditors (IIA). It has created several commitments rather than rights or obligations, in order to build and create an international organization, being united by its common mission and goals. And to adopt local preferences as well.

Its major goals are by 2013 :

- "Internal Auditing is universally recognized as a profession.
- Defines the principles of the profession and assures that the principles are available seamlessly worldwide
- Assures adherence to professional requirements.

⁹ SAI - a new Swedish state audit institution with three Auditors General - replaced Riksrevisionsverket and the Parliamentary Auditors

-
- Is the preferred provider in the research, development and dissemination of knowledge to advance the profession
 - Is seen by its members and operates as one global organization“¹⁰

¹⁰ Swedish state Institute of Auditors (SAI)

3 Concept of Internal Audit

3.1 Internal Audit definition

According to Joanna Wiella, who is an independent business advisor and member of ACCA Leinster Members' Network Panel, the internal audit should bring an added value. She examines IA and suggests that the added value of IA can be achieved by „proper annual audit planning processes which should be risk-based, and should have significant elements of in-built efficiency improvement, having regard to current business needs.“¹¹

As already mentioned previously, now days, the Internal Audit may cover the following areas¹²:

- Financial audit
- Prevention and fraud detection
- Internal control
- Audit of contracts (Investors, Suppliers, Customers)
- Audit of compliance – company's policy, processes with laws and other directives
- Operation audit
- Productivity audit
- Company audit
- Management audit
- Quality audit
- Ecological audit
- Personal development audit
- Etc.

Furthermore, the Institute of Internal Auditors defines Internal Audit „an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.“¹³

Now, I would like to explain in more details what it is meant by this definition.

¹¹ <http://www.gaap-ifs.com/biblio/Audit/002.pdf>

¹² Synek, M. a kol.: Manažerská ekonomika, Grada Publishing Praha, 2009

¹³ Definition taken from the Institute of Internal Auditors; <http://www.theiaa.org/>

- **Independent**

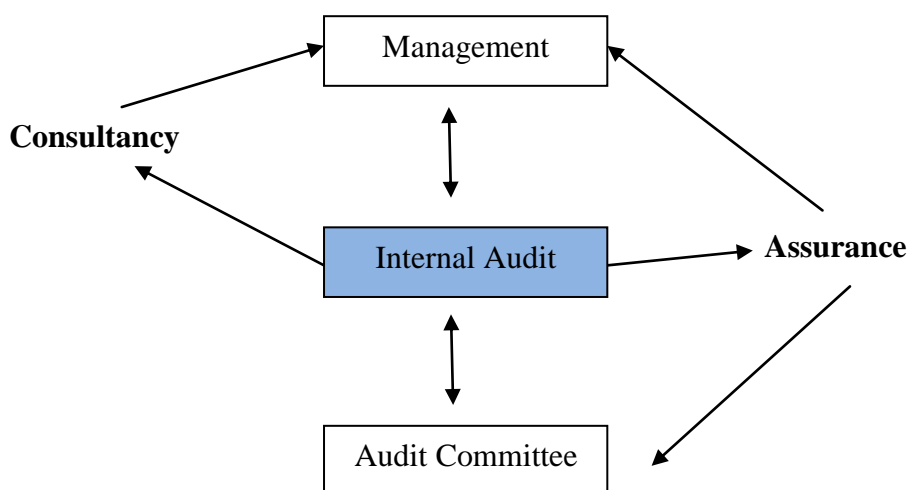
Internal auditor acts as an independent body within the company as its activities exclude any personal, material or financial interest on the audit.

- **Objective assurance**

When reporting to the management, it is assumed that internal auditor comes up with the professional opinions/analysis on the audited areas. According to these statements, the management of the company should be able to understand¹⁴:

- Risk threats
- Effectively manage the risks
- To balance risk and control
- Effectively adopt to change

The assurance is characterised by 3 different parties. Picture 1 shows the relationship among Management, Internal Audit and Audit Committee:



Picture 1 : Management, Internal Audit, Audit Committee

- **Consulting (advisory) activity**

¹⁴ Dvořáček, J.: Interní audit a kontrola, C.H.BECK, Praha 2000

Internal audit provides advisory services to the company about the risk analysis. The advisory services is characterised by 2 parties :

Internal auditor – reports to the management of the company

- **Added value**

The main goal of the company is to create a value or utility to its shareholders. When auditing, the internal auditor analyses the company's processes and its opportunities for the improvements which might be very useful for future.

- **Improve company's operations**

Internal audit summarises the flow of processes and compares it to the best practises which are applicable for the given system. The variances obtained are the places for the improvements.

3.2 Risk management, control, and governance processes

It is inevitable for the company to have the system for the identification and evaluation of potential risks in order to help the organisation with prevention. Management and control processes are methods, procedures or activities which are part of management and control system. They should help to organisation with the risk assurance. Governance processes belong to the procedures used by the representatives from stakeholders who should enable the control over the risk and management and control processes.

3.3 Users of Internal Audit

The main stakeholders in terms of the interest for Internal audit reports are:

- Shareholders of the company
- Audit committee
- Management and Board of Directors of the company
- Operational management
- External auditors

Ann moreover, the reports are received by Audit Committee as well.

3.4 Internal Audit as a discipline

3.4.1 Internal Audit vs. External Audit

Firstly, I would like to point out the common features of both audits. As they use very similar procedures and methods in order to pursue its different goals. Its main objective is to offer an independent and objective insight on the company's performance.

Internal audit's role is mainly to help to management of company with the effective risk management, management of control and managerial mechanisms. It is an advisory body which monitors and control of internal processes and practises. External audit's role is to express the statement that the financial documentation correspond with the reality meaning that it reflects the actual economic state of the company. The statements are expressed in terms of auditor's expression. It means that external auditors presume that they audit the correct data in documentation whereas internal auditors also verify if it really corresponds to the reality.

There exists different users. Internal audit is mainly addressed to management of the company whereas external audit is mainly addressed to external users such as potential investors, trading partners and others.

According to the Czech legislation, law n.254/2000 Code of law about auditors, which sets the conditions that need to be full-filled in order to be listed on the list of external auditors. The obligation is passing the exams whereas internal auditor does not need to pass the certification. External audit is regulated by the International audit standards, Code of ethics. Internal audit is also regulated by the Code of ethics mainly focused on the internal audit profession itself and Professional practice of Internal auditing.

There exist a new legislation from 26.3.2009 on auditors and it contains the changes of some laws (law about auditors). Internal audit is legislatively limited for a banking sector and public sector, for other company it is upon a management to decide, however it is strongly recommended for those companies listed on the stock exchange as well. External audit is mandatory of all types of companies which are regulated by the Accounting law.

Internal and external auditors may also cooperate together which may have a positive impact to avoid the duplicities, time and costs reduction.

3.4.2 Internal Audit vs. Controlling

Controlling and as well as internal audit mainly represent the support of management. Both disciplines are responsible for accurate, adequate and on time information. However, there exists a different main objective. Controlling's main goal is the long – term rentability of turn – over whereas internal audit focuses on the compliance of the documents with reality. Controlling is a management concept which coordinates the planning, control and information flows. It is mainly focused on the company's goals and its execution whereas internal audit is aware about the goals and tries to find out the correspondence among the reality and provided documentation.

Controlling is responsible for the detailed working out of company's partial plans – such as production plan, export plan, financial plan etc by reviewing the processes of particular departments. Then, it also coordinates the partial plans whereas internal audit revises the company's activities separately.

Controlling needs to continually manage and coordinate the processes and whereas internal audit is periodical or might be required by the other party for a given problem.

Internal audit department is an independent body in the organization and is mainly organised as a staff division. Controlling department is usually the sub-department of finance.

3.4.3 Internal Audit vs. Managerial Accounting

Managerial accounting represents a tool for the coordination of financial flows and is the base for value characteristics. It puts the main emphasis on the information in decision – making for the future development. And it creates the procedures. In comparison to Internal audit which also may revise the financial flows, however its main objective is to verify and evaluate whether the set –up procedures have been set up and work effectively.

3.4.4 Internal Audit vs. Control Self – Assessment (CSA)

“Control self-assessment (CSA) is a technique that allows managers and work teams directly involved in business units, functions or processes to participate in assessing the organization's risk management and control processes. In its various formats, CSA can cover objectives, risks, controls and processes. Internal auditors can utilize CSA programs for gathering relevant information about risks and controls; for focusing audit work on high risk, unusual areas; and to forge greater collaboration with operating managers and work teams.”¹⁵

It is inevitable to distinguish that CSA is not the alternative to Internal Audit. There exists a mutual support on both sides. CSA might include the following approaches:

- Workshops
- Questionnaires
- Managerial analysis

The advantage of CSA is the minimising of costs for control activities.

¹⁵ <http://www.theiia.org/training/index.cfm?act=seminar.detail&semID=38>

3.5 Internal auditor

In the following paragraphs, I would like to describe the profile, skills and other requirements of internal auditors and compare it to the practise. As mentioned previously, it is inevitable for these people to have also the characteristics that correspond to this profession.

3.5.1 Profile

Firstly, I would like to point out some characteristics which I believe are inevitable. The person should be a dynamic, sociable, out – going personality who disposes with the authority in order to be to reinforce his/her recommendations and to have a good timing for it. S/he should be systematic, to know follow the rules and has the negotiation skills. Internal auditor should also be patient, ethical and listen to the others in order to obtain the required information. But s/he needs to be independent on audited process at the same time. We need to take into the consideration that s/he is still the internal employee. That is why the internal auditors should be honest and objective with everyone in the company. And be able to detect a fraud and be curious.

Furthermore, the position is stressful and requires a lot of travelling. The person should have an appropriate education and needs to have a strong analytical and logical thinking. S/he should be well – informed about the internal processes and be able to follow them. Moreover, the knowledge of different disciplines is highly – recommended such as the finance, managerial accounting, corporate economics, law, marketing, statistics and quantitative methods. S/he should be able to monitor the macroeconomic situation – the situation on the market, political and legal affairs, financial development and stability, current economic trends.

Moreover, to be able to analyse the data and other required materials, the person should have a good knowledge about information technologies. Be well –informed about the company's culture and its current strategy, activities, competition. The work of internal auditor is also about constant trainings and education and as mentioned previously it is actually a mandatory part of annual audit plan. These training should also cover the soft – skill trainings.

His/her basic role is not be only the controller but s/he revises the internal processes and performance of audited units and tries to find out the optimalization for them and to be the advisor/partner for the auditees. The internal auditor should be able to observe and be able to detects the potential risks and other effects from the observations. S/he needs to find out the optimal solution for the current situation.

3.5.2 Professional Practice of Internal Auditing Standards

There also exist other requirements for internal auditors which are stated by in a professional practice of internal auditing standards which are issued by IIA.

It mainly stresses out the need for the independence of audit activities and objectivity in order not to be biased and avoidance of conflict of interests. In order to prevent such conflicts, the internal auditors should not be involved in evaluating the specific activities for what they used to responsible. However, they can act as the advisors/consultants for the internal operations where they used to work previously.

Internal auditors have a wide range of competences and it requires a high professionalism. The efficient tool for driving the internal auditors is to offer them the rotation programmes. It is ideally recommended that the internal auditor is capable and full-fills the requirements of his/her profession up to 10 years. Later on, s/he may loose the objectivity and neutrality. The rotations offer the new perspectives and possibilities. They should be flexible and sometimes they are suitable candidates for the managerial roles within the company.

It is also required that the internal auditor constantly educate himself/herself. One way is obtaining the CIA certification. Unlike external auditors who need to full – fill the requirements of the Chamber of auditors of the Czech Republic, there is no requirement for the certificate for internal auditors. It consists of 4 parts:

- Part 1 : The Internal Audit Activity's Role in Governance, Risk and Control
- Part 2 : Conducting the Internal Audit Engagement
- Part 3 : Business Analysis and Information Technology
- Part 4 : Business Management Skills

The other conditions are to have at least 2 years of experience in internal audit or other equivalent profession. The equivalent profession might be an academic degree obtained after bachelor degree (covers 1 year of professional experience) or teaching at the university for 2 years covers 1 year of experience. The other presumption is to have at least a bachelor's degree obtained at the university and to express the agreement with Code of Ethics.

3.6 Professional Practice of Internal Auditing

The Institute of Internal Auditor (IIA) issued “ Standards for the Professional Practice of Internal Auditing“ already in 1978 and has developed them with the addition of guidelines and Statements on Internal Auditing Standards (SIASs). In addition, it has also issued the *Statement of Responsibilities of Internal Auditing* which summarises the role and responsibilities of internal auditing, and the *Code of Ethics* which each IIA member agrees to abide by.

Professional Practice of Internal auditing is also published by Czech institute of internal auditors. It covers the following areas:

- Code of ethics
- Definition of Internal Audit
- International standards for professional practice of Internal Auditing
- Recommendations for practice of Internal Auditing

Ethical code, Internal Audit definition and International Standards are mandatory and other documents are recommendations/instruction which should further explain the Standards and enabling their comprehension and execution in a reality. The recommendations may be targeted on specific audit project in industrial sectors and activities such as ecologic, information technologies, audit of state institutions and others.

3.6.1 Code of Ethics

“The Code of Ethics of The Institute of Internal Auditors (IIA) are Principles relevant to the profession and practice of internal auditing, and Rules of Conduct that describe behaviour expected of internal auditors. The Code of Ethics applies to both parties and entities that provide internal audit services. The purpose of the Code of Ethics is to promote an ethical culture in the global profession of internal auditing.”¹⁶

¹⁶ <http://www.theiia.org/guidance/standards-and-guidance/ippf/standards/full-standards/>

3.6.2 Standards for professional practice of Internal Auditing

Its main objective is to provide the guidance and framework of basic principles of best practice of internal auditing. Then, to create an evaluation based for internal audit performance and as well as to improve organizational processes and operations. “The structure of the Standards is divided between Attribute and Performance Standards. Attribute Standards address the attributes of organizations and individuals performing internal auditing. The Performance Standards describe the nature of internal auditing and provide quality criteria against which the performance of these services can be measured. The Attribute and Performance Standards are also provided to apply to all internal audit services.”¹⁷

I would like to also mention several basic principles for the internal auditors such as the integrity, objectivity, reliance and competence. Internal auditors should follow these principles.

3.6.2.1 Integrity

Internal auditors are obliged to perform their work responsibly and honestly. They need to respect the external (law) and internal rules/procedures and provide the interested parties with the accurate and real information. They should also respect the legal and ethical goals within the organization and be able to contribute to its achievements.

3.6.2.2 Objectivity

This principle regulates the internal audit activities that might cause the violation of the internal auditors objectivity and that is why, the internal auditors should not take or be influenced by anything which may influence their perception. The internal auditors should only interest in the relevant and compact information.

3.6.2.3 Confidentiality

Internal auditors work with confidential information and its duty to protect them as well. The information cannot be used for any personal gain or other manner which is against any legal and ethical directives of the organization.

¹⁷ <http://www.theiia.org/guidance/standards-and-guidance/ippf/standards/full-standards/>

3.6.2.4 Competence

Internal auditors should only conduct the services for which they possess the necessary knowledge, skills and experience. And all services should be carried out in accordance with the professional practice of internal auditing.

3.7 Establishment of Internal Audit department

If a management of the company decides to set – up a new department of Internal Audit, its main aim is to increase the effectiveness of internal processes within the company and as well as to have a signalization of potential risks. It should correspond to the size, economic situation of the company. Moreover, the other preliminary conditions are sufficient information and communication system and level of internal controls.

It is also important to mention that if a company decides to create an Internal Audit department, it should definitely have the auditing experience from independent auditors. It enables to the employees to understand the basic principles and methodology.

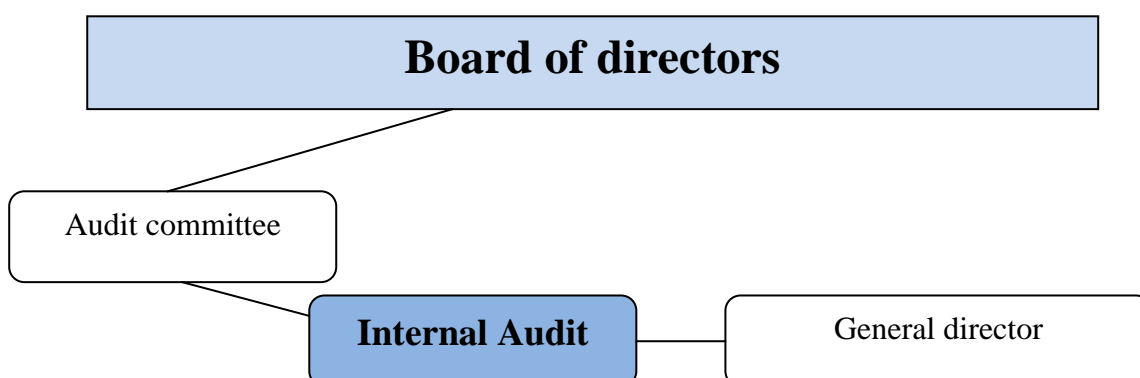
Publicly-traded corporations typically have an internal auditing department, led by a Chief Audit Executive ("CAE") who generally reports to the Audit Committee of the Board of Directors, with administrative reporting to the Chief Executive Officer.

3.7.1 Internal audit department in the organization structure

There exists different organization structure for internal audit department in the companies and it mainly depends on the type of organization – more specifically private and public companies. Its main objective in the organization is to analyse and evaluate the organization of the company, to verify and analyze internal controls and processes, to control the full – filling of directives, rules and to inform the management about the findings and as well as to make the recommendations for the improvements.

The department should guarantee the independence for creation and realization of execution of audit activities. And that is why, it should report directly to the audit committee and not to general director of the company.

Picture 2¹⁸ shows Internal Audit department within an organization



Picture 2 : Internal Audit department

3.7.1.1 Corporate Governance (CG)

The organization for economic cooperation and development (OECD) launched a directive called “The principles of corporate affairs“. The principles highlight the recommendations for joint – stock companies in terms of division of ownership and control. This document also refers to the other parties = stakeholders. CG also regulates the optimal structure and mechanisms for the effective fulfilling of company’s goals and as well as monitoring of the performance. There exists commonly accepted principles of CG such as:

- Rights and equitable treatment of shareholders
- Interests of other stakeholders
- Roles and responsibilities of the board
- Disclosure and transparency
- Integrity and ethical behaviour

3.7.1.2 Audit committee (AC)

It is recommended by the Institute of Internal auditors to establish the audit committee. It is crucial that the AC members are fully independent of the company’s results. It is usually established by the board of directors and should act as a support body for supervising of controlling activities. Furthermore, “the audit committee performs various activities in overseeing the internal audit structure . It also ensures that the internal audit function is a quality function.”¹⁹

¹⁸ Dvořáček, J. a kol.: Interní audit , 1996

¹⁹ Burke F. and col.: Audit committees: A guide for directors, management, and consultants, CCH, 2008

Moreover, the other activities cover the internal audit plans and the results of internal audits. It enables the audit committee to have the current information about the internal control and processes and as well as the financial performance of the company.

“One of the audit committee’s responsibilities is to oversee the internal audit function. The audit committee is assigned this responsibility because the internal auditor helps the audit committee to fulfil its responsibilities of overseeing risks and control over financial reporting, the integrity of the financial reporting process.”²⁰

The other responsibilities is the cooperation with the management of the company in the internal control mechanisms, improvement of annual plans, examination of the annual and semi-annual financial reports, external audit statements and findings, evaluation of internal audit’s goals, assuring the communication mechanisms among management and external and internal auditors, approval of final report of internal audit before its issuing.

Sarbanes – Oxley Act issued by USA Congress in 2002 (after a several bankruptcies of American companies such as Enron) . The act requires the establishment of AC for all companies which are listed on American stock of exchange.

Some requirement of Sarbanes – Oxley act are:

- All listed companies on the American stock exchange need to establish the AC which needs to be fully independent body of the company
- All members of AC should be independent of the company itself
- AC must approve the audit as well as non – audit operations and activities
- Internal auditors are controlled and report to AC

3.8 Classification of Internal Audit²¹

There exist 2 main types of internal audit:

- According to **time schedule**, there is:
 - Planned IA - which is prepared for 1 year
 - Demanded IA - which is requested from management of company
- According to **Internal Audit scope**, we distinguish:
 - Overall IA – which is focused on overall revision of the activities
 - Partial IA – which is focused on a particular function or activity
 - Specialised IA – which focuses on a particular details of particular departments

²⁰ Burke F. and col.: Audit committees: A guide for directors, management, and consultants, CCH, 2008

²¹ Synek, M. a kol.: Manažérská ekonomika, Grada Publishing Praha, 2007

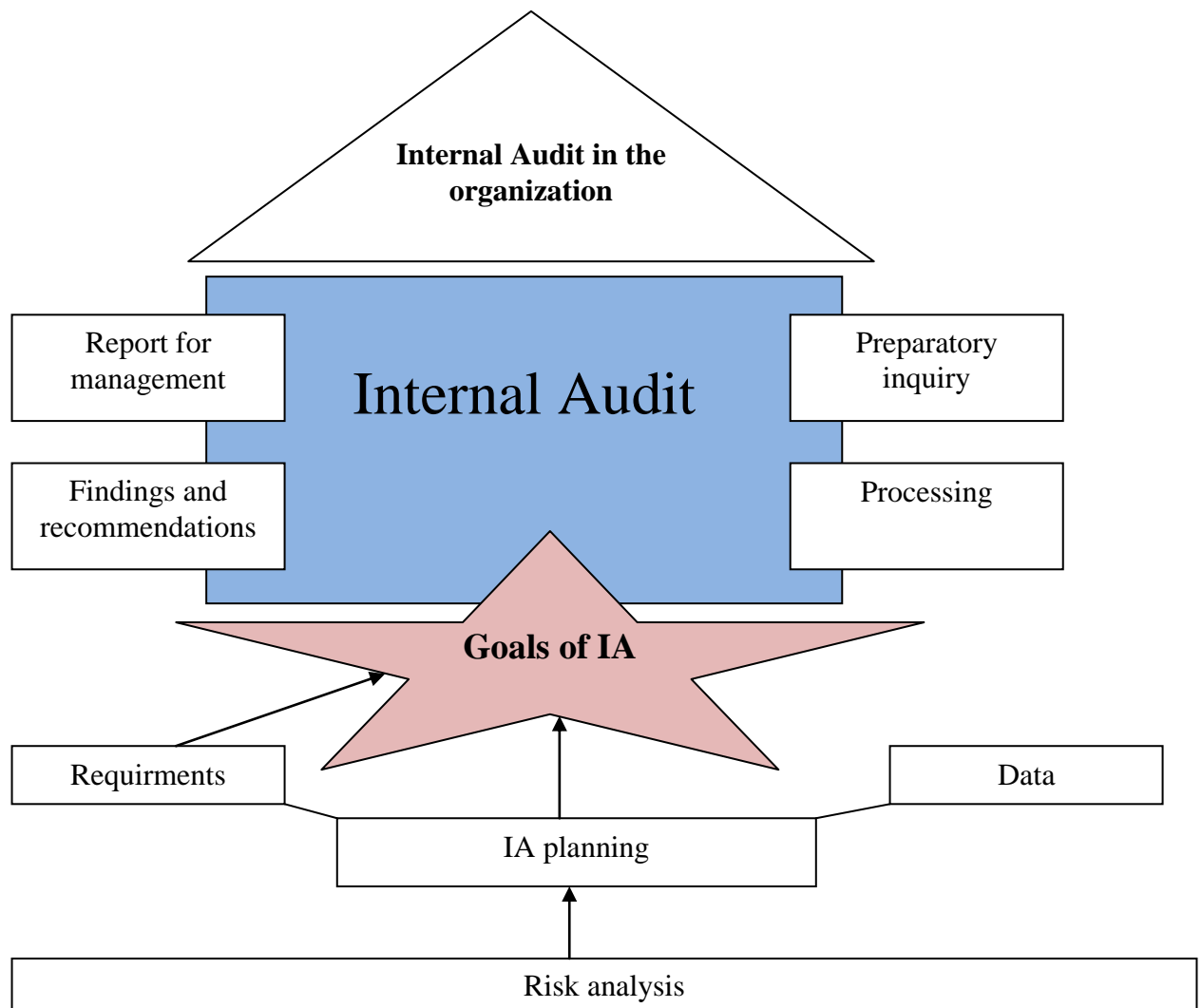
4 Methodology of Internal Audit

This chapter revises the main procedures in methodology of Internal Audit. In the literature, we can find more approaches for a methodology itself.

The first one is recognized as a traditional audit. The planning is recognised from the given goals of audit and tries to identify various managerial techniques and controls.

The second one, which i am going to describe, is based on a risk analysis, also called a risk audit.

Picture 3 below shows the methodology of Internal Audit.



Picture 3 : Methodology of Internal Audit

4.1 Risk Analysis

A risk can be defined as the probability that the other result that expected one happens. These results can be positive or negative. In risk management, it is inevitable to identify and quantify a risk, then to work out a cause analysis and further to try to manage a risk. It means to take measures in order to eliminate any risk or its impact. Management and auditors must consider how the risk should be managed, what actions and controls need to be taken. There exist preventative procedures which reduce the significance or likelihood of the risk. Secondly, there are displacement procedures in order to offset the impact if it occurs.

4.1.1 Risk Assessment²²

Evaluation of significance of risk is based on risk assessment. It determines the expected probability of intensity (I) and frequency (F). Their mutual relation is shown in the following table.

		Frequency	
		Low	High
Intensity	Low	I	II
	High	III	IV

Picture 4: Risk Assessment

We distinguish 4 different groups of risk:

1. Low frequency, low intensity

It mostly represents damages that the company does not need to take into the consideration as they are not very probable to happen. They occur rarely and they do not have any serious impact on the company.

²² Dvořáček, J., Kafka, T.: Interní audit v praxi, Computer Press, Brno 2005

2. *High frequency, low intensity*

These damages occur more frequently and the company should take it into the consideration. It should search for the solutions in order to reduce their occurrence. However, they have a little impact on the company.

3. *Low frequency, high intensity*

The risks in this group are rarely probable to happen, however the companies should take the pre-step measures in terms of the insurance. The caused damages may have a severe impact on a business. Examples are the natural disasters or calamities.

4. *High frequency, high intensity*

If a risk analysis determines the risks in this group, it represents a serious danger for the company. And it should be an immediate warning. It is not possible to neither insure them nor prevent them. Therefore, the company should take into the consideration to leave a part of a business (where they occur) because it may have a severe impact on the business.

4.2 Internal Audit Planning

After a risk analysis, the internal audit should further concentrate on planning process of an audit. The plan specifies the main areas of interest and it is a systematic process which is based on the evaluations of risks and scale of risk.

When planning an audit, it is inevitable to take into the consideration – risk analysis, interests of management and legislation, strategy and goals of a company, the results of previous audits and recommendations of other stakeholders such as external auditors, bank.

The process of planning covers the formulation of following areas:

- Goals
- Time schedule
- Human resources and financial plan
- Report on activities

In companies, we can find several different types of plans of activities of Internal audit department. We distinguish the following plans:

-
- Strategic
 - Annual
 - Operational (Quarterly – based, Monthly – based)

The strategic audit plan must be approved by a management and it should be flexible. The theoretical example of such a plan may be found in picture 5 below.

Number	Priority	System/ Subsystem	Name/ Theme	Audit subject	Type (of IA)	Cycle (n° of audits)

Picture 5: Audit plan

4.3 Execution of Internal Audit

The realization of Internal Audit has several steps:

- Identification of needed information and data in order to reach the goals of audit and to identify the sources of these data
- Analysis and assessment
- Documentation of reality and summarising of findings in report

4.3.1 Internal Audit Memo

It is a document which assigns the tasks to internal auditors. This assignment consists of:

- Name of the audited company
- Number of memo
- Subject of audit
- Request for supplementary information
- Audit team
- Date of audit

4.3.2 Internal Audit Program

Internal Audit program provides objectives and conditions of a particular audit. A program is derived from the annual audit plan.

Program structure

- Identification
- Audit objective
- Factual, time and capacity audit definition
- Procedures, methods and techniques of IA
- Time schedule for finalising a report

4.3.3 Internal Audit techniques

Auditors choose particular techniques according to audit activities and goal while corresponding to the costs and utility that the techniques bring.

➤ **Interview**

Interview or conversation is suitable when the necessary cannot be observed.

➤ **Comparative analysis**

This method is used to compare data from various different sources in order to identify deviations.

➤ **Flowchart**

This technique is very useful as it is a graphical representation of inputs, activities, decision-making processes and outputs related to the relevant processes. It represents a mapping for existing processes in order to improve their effectiveness. For planned process, it is used to determine whether the action will be pursued in most efficient way.

➤ **Representative sampling²³**

It is an auditing procedure to create a representative group of less than 100% of the items within a homogeneous group for the purpose of evaluating of this group. Sampling can be statistical or non – statistical. The most preferred sampling approach is non – statistical sampling. There exist three key steps in a non – statistical sampling process:

- To determine the control test objective, population and sampling unit,
- To determine the sample size
- To select the sample for testing

Sample size

The sample size depends on the frequency of the control and the level of evidence required by the engagement team.

The table below shows the recommended frequencies of control and its range of items according to Sarbanes projects. However, for internal audit use, a smaller sampling size may be used depending on the specific circumstances.

Frequency of Control	Sample Size
Annual	1
Quarterly	2
Monthly	2 to 5
Weekly	5 to 15
Daily	20 to 40

Picture 6: Selection of sample

It is inevitable to obtain a representative sample of the group. In order to guarantee that the sample is really representative, all items should have an equal opportunity of being selected. There exists the following methods:

- *Random selection*

²³ Internal Audit Manual, Skanska AB

A method, which ensures that all items have an equal chance to be selected.

- *Systematic selection*

It is used to minimize any potential human judgement or bias. There exists a defined sampling interval.

- *Haphazard selection*

Internal auditor chooses randomly the sample items without any special reason for including or excluding items for the sample.

➤ **Observations**

It represents a planned and systematic monitoring of certain facts. The outcome of observation is not only a description of reality, but its interpretation and explanation.

➤ **Comparison**

It is used for detection of identical or different sites for two or more different objects in order to compare.

➤ **Induction and deduction**

This method mostly reveals the identification of causes and effects of certain reality.

➤ **Mathematical and statistical methods**

They express hypotheses for future using mathematical formulation. Moreover, statistics exactly affects the economic interdependence between different variables.

➤ **Modelling**

The model is a simplified picture of reality which represents the characteristics of this reality. It is a tool for systematic simulation.

4.4 Reporting of findings and results

During execution phase, the internal auditors come up with the audit finding and rate the overall audit. The audit results and its communication represent one of the key factors of whole internal audit process. According to Standards for Internal audit, the internal auditors are obliged right after completion of audited project to report the findings to the internal users such as management of the company and audit committee.

The audit results are summed - up in audit report which needs to have a special format. It contains the main objectives and scope of audit, findings and observations, conclusion and recommendations.

The audit report is a tool how to inform the management of the company about the performance of particular business units and to convince the management about the credibility of findings and changes needed. The report should fulfil several criteria such as clear, brief and concise. The content should be also adjusted according to current needs of end users.

Internal Audit Standards also specify the cases when the standards are not followed as well as other criteria for the content of audit reports.

4.5 Evaluation of internal audit²⁴

Another important phase is the evaluation of internal audit as it is also required by Internal Audit Standards. There exist Standard 1300 called “Program for improvement of quality assurance and internal audit”. It says that the head of internal audit department should work on regular updates of plans in order to guarantee and improve the quality of internal audit.

There also exists Standard 1311 called “Internal Evaluation” and Standard 1312 called “ External Evaluation“. It distinguishes two different quality assessments such as internal

²⁴ Professional Internal Audit Standards

quality assessment (IQA) and external quality assessment (EQA). IQA represents the ongoing examination of internal auditing as well as regular self – assessment or the evaluation by third person in the company who is familiar with the these standards and IA practises. EQA is carried out by the independent external qualified person or team at least once in five years time. The main objective is to evaluate the IA compliance with standards and legislation directives adn regulations, to identify the weaknesses and strengths, and to make the recommendations for improvements of efficiency of operations and procedures.

5 Internal Audit in Skanska

5.1 SKANSKA group²⁵

First Skanska, the company, was originally founded in 1887 when Aktiebolaget Skanska Cementgjuteriet was established and it started by manufacturing concrete products. The first international operation was already founded in 1897. The company was listed on the Stockholm Stock Exchange A-list in 1965. In 1984 “Skanska” became the Group’s official name.

Now days, Skanska is 10th largest construction company²⁶ worldwide. And it operates in 4 main businesses and in selected regional markets such as Europe, the USA and Latin America. It employs around 60 000 employees.

The businesses are Construction, Residential Development, Commercial Development and Infrastructure Development.

Geographically, in the US, which is Skanska’s single largest market, they are a leading company within building and civil engineering projects. Skanska also tries targeting the US Public-Private Partnerships (PPP) segment.

In Northern Europe, Czech Republic, Slovakia and Poland, the operations mainly cover construction and investment businesses. In the UK, they are classed as a leading player in construction as well as within PPP.

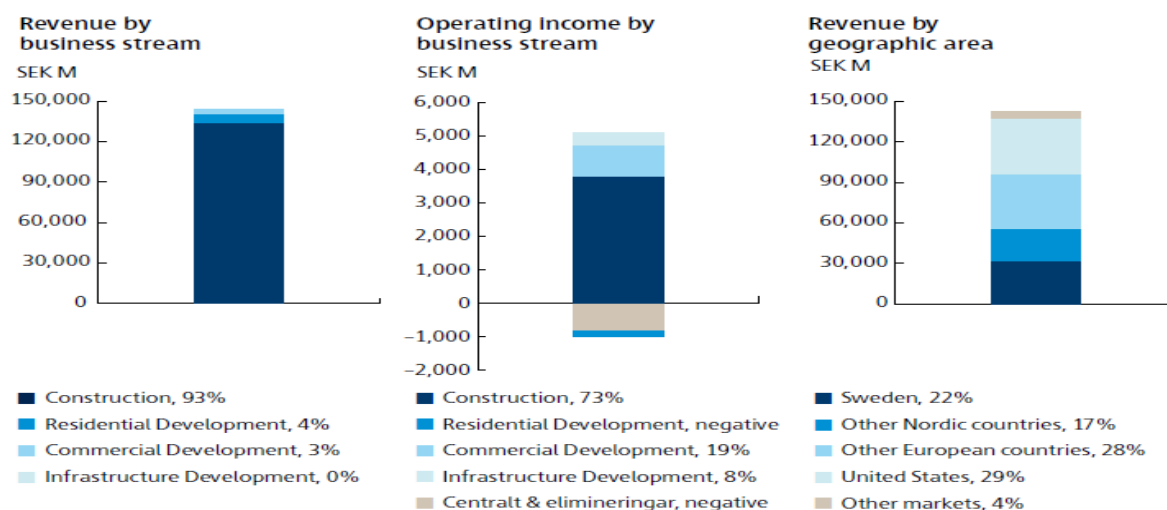
In Latin America, Skanska concentrates more on the oil, gas and energy sector and in PPP.

The picture 7²⁷ below shows the percentage coverage of the business activities and the operating income as well as revenues by particular geographical areas.

²⁵ <http://skanska.com/en/About-Skanska/>

²⁶ <http://www.stavebni-forum.cz/cs/article/134/skanska-v-ipsu/>

²⁷ Skanska Annual Report 2008



Picture 7: Business Activities and Operating Income of Skanska

Key ratios for Skanska group are shown in picture 8 below²⁸.

	SEK M	EUR M	USD M
Revenue	143,674	14,923 ³	21,802 ³
Operating income	4,086	424 ³	620 ³
Income after financial items	4,410	458 ³	669 ³
Earnings for the period per share, SEK/EUR/USD ¹	7.44	0.77 ³	1.13 ³
Return on equity, %	15.9	15.9	15.9
Return on capital employed, %	18.3	18.3	18.3
Order bookings ²	126,524	13,142 ³	19,199 ³
Order backlog ²	142,402	13,012 ⁴	18,440 ⁴

1 Earnings for the period attributable to equity holders divided by the average number of shares outstanding after repurchases.

2 Refers to Construction operations.

3 Average 2008 exchange rates: EUR 1 = SEK 9.63, USD 1 = SEK 6.59.

4 Exchange rates on 2008 balance sheet date: EUR 1 = SEK 10.94, USD1 = SEK 7.72

Picture 8: Key financial ratios of Skanska group in 2008

²⁸ Skanska annual report 2008

5.1.1 Mission and Strategy

Skanska's mission is to develop, build and maintain the physical environment for living, working and transportation. And its strategy is focused on core businesses in construction and development by systematically managing risks and using employee expertise, brand and financial resources to become a leading company in selected home markets.

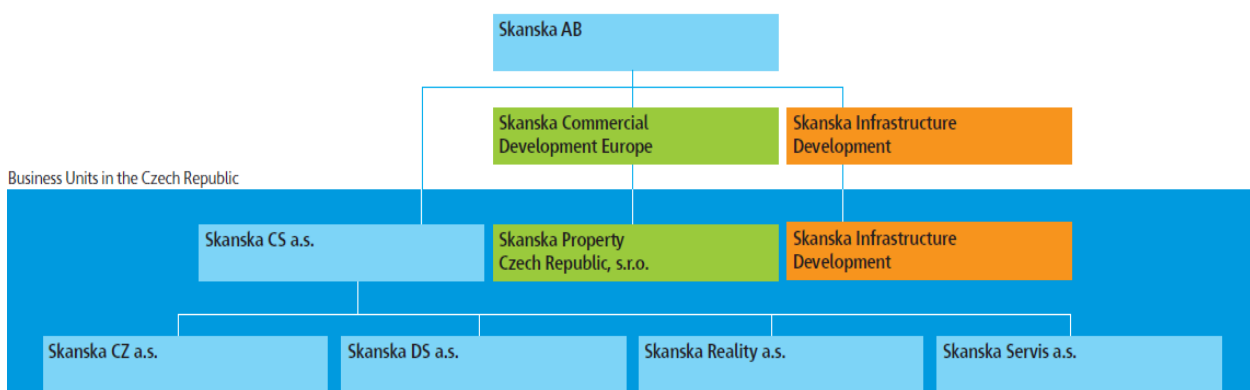
The strategy is presented as „5 zeros“ meaning:

1. No loss projects
2. No ecological incidents
3. No accidents
4. No defects
5. No violation of ethics

5.1.2 Skanska in the Czech Republic

The Skanska group began to operate in the Czech Republic in the 1950s when it bought company called IPS. IPS, originally started as a company Zemstav, which was a specialized company in earthworks. In 2008, there was a change of structure from divisional to holding and group is headed by Skanska CS a.s. and 100% owner is Skanska AB with its headquarters in Sweden.

Picture 9²⁹ below shows organizational structure:



Picture 9 : Skanska group organization structure

In the Czech Republic, Skanska is represented in all its key business activities:

²⁹ Skanska annual report 2008

1. Skanska CS – comprehensive construction and development holding with many specialised services

- Skanska CZ a.s. specializes in building construction (such as Building construction, Technology and Concrete Structures)
 - Major investors are private investors
- Skanska DS a.s. specializes in traffic engineering
 - Major investors is state -Ředitelství silnic a dálnic and Správa železnic
 - It creates the biggest turn – over for Skanska CS a.s. as it covers construction of roads, high- ways, railways, bridges ...
- Skanska Reality a.s. specializes in residential and commercial development, sale of real estate
- Skanska Servis a.s. specializes in shared service activities relating to procurement, security, quality and safety

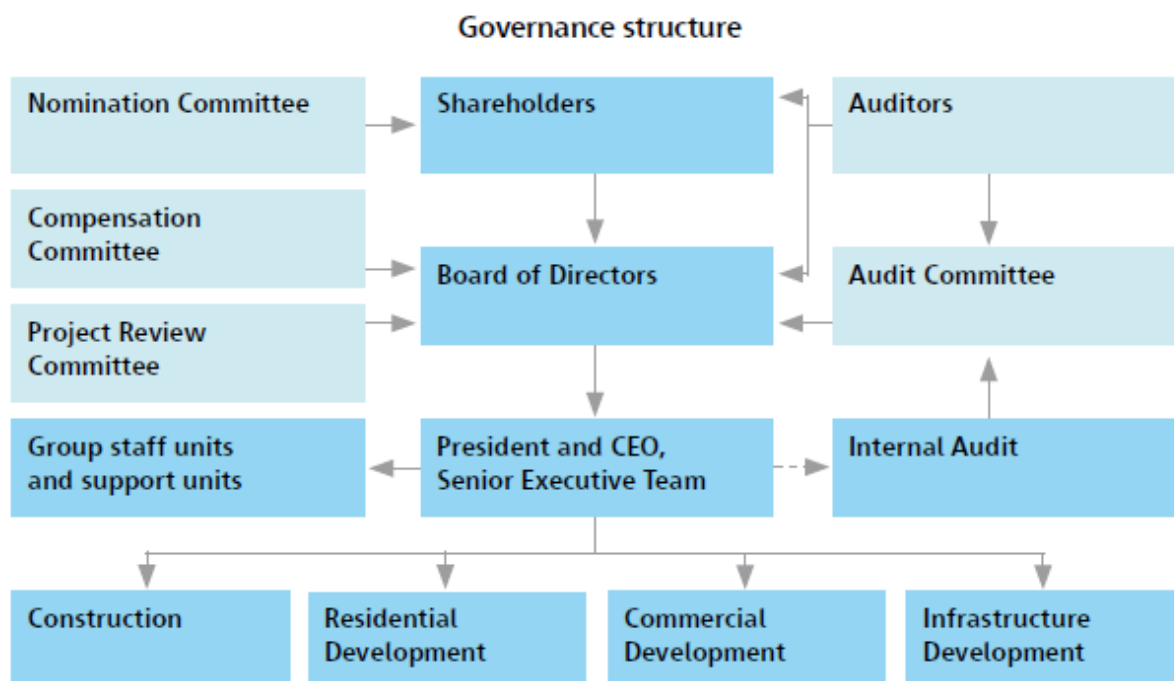
2. Skanska Property Czech Republic – development and sale of commercial projects

3. Skanska Infrastructure Development – development and operation of projects in the area of PPP

Major competitors on the Czech market are Metrostav a.s, Hochtief a.s, Unistav a.s, Strabag a.s, Alpine a.s and others.

In 2009, Skanska CS a.s obtained 9th place as most admired company 2009 which was organised by Czech Top 100.

5.2 Internal Audit in Skanska



5.2.1 Organization

Picture 10: Skanska Governance structure

5.3 Role and scope of work³⁰

Role and scope of the Internal Audit at BU Skanska CS is defined in the Status of Internal Audit.

The Audit department at BU Skanska CS is an integrated part of the Group Staff Unit Internal Audit and Compliance (Internal Audit).

Its major role is to determine whether the BU Skanska CS internal control, risk management and governance processes, as designed and represented by management, are adequate and functioning and as well as to make sure that:

- Major risks are identified and managed on time and correctly.
- To ensure that Group policies and other rules comply with BU Skanska CS policies and as well to ensure their right implementation and efficient working.

³⁰ Internal Directive Skanska AB, Internal Audit at BU Skanska CS a.s.

-
- Employee's actions are in compliance with BU Skanska CS policies, standards, procedures, and applicable Czech and/or Slovakian laws and regulations.
 - Financial reporting on projects is accurate and reliable focusing on both projects requiring SET or BU Skanska CS approvals and projects reported as large/loss.

The Czech based team of Internal Audit is lead by the Chief Audit Executive (CAE) who reports directly to the SVP GSIAC (Group Staff Internal Audit and Compliance). The other members of the Czech based Internal Audit department report to the CAE. For administrative purposes the CAE reports to the Chief Executive Officer (CEO) of BU Skanska CS.

Key responsibilities³¹ of Internal Audit department in the CR are to:

- Perform an annual risk assessment of the existence and effectiveness of the controls in place to manage the major risks within the BU Skanska CS,
- Develop a flexible audit plan using a risk-based methodology, including any risks or control concerns identified by management or the Supervisory Board, and submit that plan to the SVP GSIAC for review and approval,
- Execute the annual audit plan, including any special projects requested by Supervisory Board and/or the Audit Committee, as appropriate, in accordance with relevant professional standards, internal policies and procedures,
- Prepare a written report for each internal audit engagement performed describing the internal audit's summary, evaluation, findings and recommendations. The reports are directed to the CEO and CFO of BU Skanska CS and the Director/Manager responsible for the area being audited. Copies of the report are sent to the Skanska EVP, CFO Skanska AB and Business Controller responsible for BU Skanska CS as well as to the SVP GSIAC and SVP Controlling. The distribution lists for any reports on special projects are decided on a case-by-case basis, depending on content,
- Establish and maintain system of monitoring and reporting the remediation of the internal audit recommendations,
- Maintain a professional audit staff with sufficient knowledge, skills, experience, and professional certifications,
- Assist in the investigation of significant suspected fraudulent activities within the organization and notify the SVP GSIAC of the results. Also, maintain an awareness of potential Management fraud "red flags" while conducting normal audit activities,

³¹ Skanska Internal Directive 2009, Internal Audit at BU Skanska CS a.s.

-
- Maintain a communication with the external auditors in matters relating to internal control.

Internal Audit team in the BU, consists of CAE and the auditor.

More specifically, the main responsibilities³² of CAE are as following :

- Audit announcement,
- Audit scope issuing,
- ACL tests,
- Selection of items for samplings,
- Sending of the draft to auditees,
- Final report issuing,
- Communication with Skanska AB,
- Communication with BU management,
- Supervision of the team.

The auditors are responsible for:

- Collection of related external/internal procedures and rules,
- Valuation of those rules (aging, validity, comparison of internal and external rules),
- Performing, in conjunction with CAE, of sampling of,
- Proper documentation of all memos and results,
- Thoroughfare of all findings results within the whole audit team,
- Communication of all suspicious of potential frauds primarily with CAE than some action will be taken,
- Presentation of all audit findings to CAE immediately when they will be proved,
- Presentation, in conjunction with CAE, of results to auditees.

5.4 Risk Management

The Senior Executive Team (SET) is responsible for managing strategic risks, such as political, social or macroeconomic risks. As the every project in construction business is unique, the risk management is one of the crucial cornerstones of Skanska's success. It is inevitable to take into consideration that these projects are the major sources of revenues. In the construction business, operational risks are substantially higher than financial risks. That

³² Skanska Internal directive – Internal Audit's scope and planning

is why each project is evaluated on a quarterly basis and being adjusted by the percentage of completion being made for any changes in the estimated project completion cost.

During audit, it may occur that project that has previously reported a profit, is classified as a loss – making project and must expense all previously estimated profit. And at the same time, the entire loss must be recognized. The project is for rest of construction period reported with zero gross income.

5.4.1 Approval process

There also exists the rules of Authorization limits where there are mentioned key responsible persons and decision – making Skanska organizational departments for the approvals of activities such as contractions with the contract partner, investments in long – term capital, liabilities for construction supervision etc.

The map of risks was created for Skanska operated in Slovakia and Czech Republic and key responsibilities of SET were identified. The risks are divided into 2 groups:

- *Key attributes*
- *Critical risks*

5.4.1.1 Key attributes

It is to identify the key competences where the project is classified whether it increases the risk or not. Then, key geography means that Skanska CS may realise projects in Slovakia and Czech Republic, for other projects – it needs SET approval. Furthermore, the classification of key roles such as contractions activities, construction supervision, design and build. Finally, the identification of type of contracts which states the limits for the approval by SET.

According the key attributes evaluation, project's risk zone is identified. Such as :

- *Green zone* - all attributes are full - filled
- *Yellow zone* – one attribute is not full - filled
- *Red zone* – two and more attributes are not full – filled

SET is responsible for the projects in yellow and red zone.

5.4.1.2 Critical risks

Each critical risk has its own limit and its exceeding requires SET or PRC (Project Review Committee) approval.

The critical risks are identified as following:

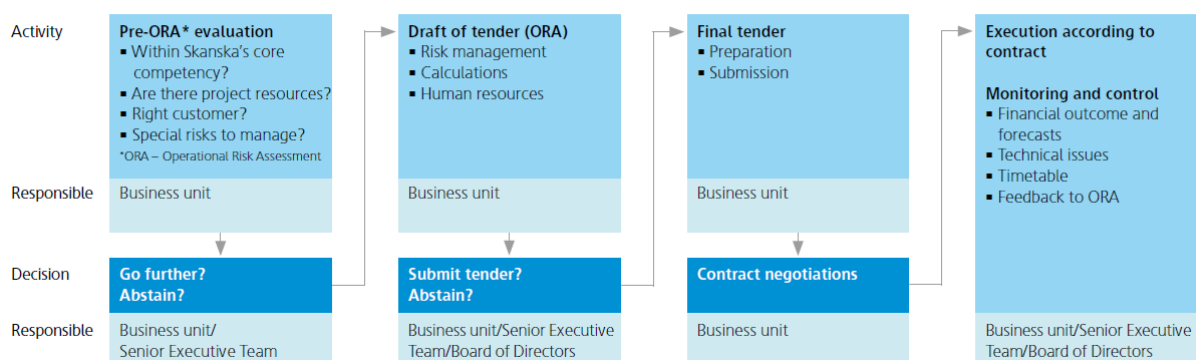
- Joint venture with the chosen partners, other partners or partners that are not construction companies
- Non – construction processes such as output guarantees and assurances
- Financial risks
- Ethical code risks
- Experienced or risky developers
- SPV (Special Purpose Vehicle) which represent the companies established for a given purpose.

Secondly, after the initial evaluation of potential risks, SET and/or Skanska AB Board of Directors approves according to Skanska Procedural Rules.

For identifying and managing potential risks, Skanska uses Tender Approval Procedure (STAP) and the pre - Operational Risk Assessment (pre- ORA) and ORA.

Picture 11 below shows the procedures in Tender Approval process.

Skanska Tender Approval Procedure (STAP)



Picture 11: Skanska Tender Approval Procedure (STAP)

These tools evaluate construction projects during tender preparation with regard to the technical, legal and financial risks. The analysis also include other aspects such as ethical,

social and environmental ones. Furthermore, it monitors and updates these aspects during the execution period as the project progresses.

The ORA process creates a systemized preparation for the tender evaluation. Concerning new projects, these are analyzed in terms of the strengths of business operations including geographic markets, contract type and size, project resources.

In 2008, a new group of experts, the SET Risk Team (SRT), was created in order prepare and evaluate the proposals submitted to the Senior Executive Team for decisions. There exists a support unit , The Skanska Financial Service, which is responsible for evaluating financial risks related to credit risks, payment flows, customers, subcontractors and joint venture partners.

Pre- ORA and ORA documents are submitted by the Business Unit to the responsible EVP (Executive Vice President) 10 days before a scheduled SET Tender Board (STB). ORA working group focuses on following areas, also called 5 top risks:

- Law
- Finance
- Techniques
- Social - Environment
- Ethics

Working committee has the risk specialist in each selected area and the specialist evaluated the potential risks. ORA is prepared at least 3 months before the project execution.

Generally, we can distinguish among several main risks in the construction business:

- *Operational risks* such as material prices, labour costs
- *Financial risks* such as liability and security of client/investor – called refinancing risks and liquidity and a foreign exchange rate, interest rate.

5.4.1.3 Operational risks

Firstly, when evaluating operational risks, we should mainly consider many different types of contractual mechanisms. It means that the risk associated with the prices of goods and services varies greatly, depending on the contract type.

Most preferable for Skanska is if it operates on a cost-plus basis, meaning that any price changes are directly passed to the client. However, in projects for public sector customers (it is a secure client in terms of financial guaranties), Skanska operates on a fixed-

price contracts. Certain contracts also include indexing clauses that enable a revision of the contract value regarding to the price changes.

5.4.1.4 Financial risks

Construction business requires high initial capital investments that are why the refinancing risk is arise. It is mainly caused by lack of liquidity or by difficulty in obtaining or rolling over external resources such as loans. Skanska relies on trustworthy investors and that is why the majority of its construction business is developed by traffic engineering where a client is a public sector.

Globally for Skanska³³, the average maturity of the borrowing portfolio, including the maturity of unutilized crest was 5,5 – 6,5 years in 2008.

Foreign exchange risks arise as Group's equity are invested in foreign subsidiaries. Skanska hedges its equity in markets/currencies where it has a relatively large proportion of its equity invested.

The outcome of risk assessment is a risk map which displays the potential risks that a business processes might be affected by and it determines the selection of the areas of interest for the audit team when preparing an annual audit plan.

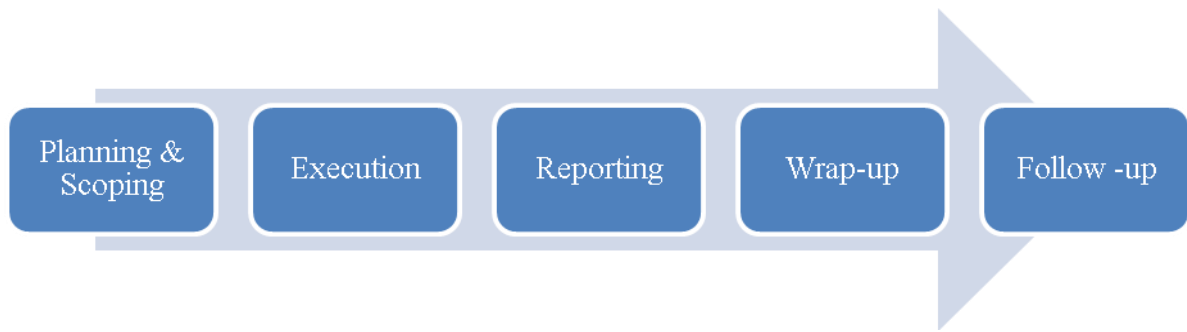
5.4.2 Cooperation Internal Audit and Risk management department

As observed, there exists cooperation between IA department and Risk department in Skanska. The key point which needs to be mentioned is that Risk department prepares and analyses the input information for the execution of IA as well. And it evaluates the potential risks on a scale low up to high potential risks.

However, there does not exist any special Skanska internal directive for the exchange of information and data flow. Key competences and roles are defined in IA Status. Risk working committee gives the recommendation and final evaluation what should be further monitored and analysed when the project is approved. Internal auditors are informed about the risk committee decision for the project.

³³ Skanska Annual report 2008

5.5 Internal Audit processes



Picture 12: Internal Audit process

5.5.1 Planning

Planning phase is important in order to enable the internal audit team to give the insight into the realised projects and as well as to identify the risks and control objectives to develop the scope of the project. The audit planning covers the following projects:

- All loss projects
- Large lists projects
 - These are projects whose budges is over 750 millions CZK
 - It mainly concentrates on those projects whose tender margin differs from action margin
- Audit of supporting processes where a risk was presumed or already detected - such as Account Payables & Account Receivables,
- Management required projects/process

The phases are as following:

Project initiation	<ul style="list-style-type: none">• lasts 35 working days from Kick - off meeting• includes project start, team mobilization, setting - up project file
Audit Announcement	<ul style="list-style-type: none">• lasts 30 working days from Kick-off meeting
Understanding of reviewed area	
Scoping meeting	<ul style="list-style-type: none">• lasts 25 working days from Kick-off meeting
Project Risk Assessment and Scope	
Planning Memo	<ul style="list-style-type: none">• lasts 20 days from Kick- off meeting
Team Planning Memo	<ul style="list-style-type: none">• lasts 5 working days form Kick - off meeting

Picture 13 : Phases of Internal Audit Planning

The planning calendar is done normally in 3rd quarter of previous calendar year and it is prepared by CAE of Skanska CS. The result of planning process is an audit plan. Then the plan is approved by Audit committee of Skanska AB. It is flexible as 75% is created by predefined audit projects in advance and 25 % is fully flexible in case of special shareholders interests.

In Skanska, the planning phase starts with the project initiation and team mobilization. The CAE and Project Manager should review the initial budget estimate for the project.

Internal Audit team of Skanska CS is fully independent from any local interests. However, in order to obtain the information on projects, it preliminary cooperates with Risk department, Controlling and Financial department, Sales department as well as Project team. And it may also consult some external partners such as external auditors if needed.

The key issues for audit are identified concerning of any special knowledge or functional experts.

Each internal audit project needs to be documented using an appropriate work paper system in written and approved form.

5.5.1.1 Plans

When planning, the internal auditors may also personally verify the planned projects at the potential audited unit, in order to get more information when being there personally and also to have an idea what should be prepared and done next.

5.5.1.2 Audit announcement

Later on, the audit team notifies the auditees via a formal announcement letter. The timing is approx. 30 working days (6 weeks) in advance. The formal announcement letter is followed by informal communication of the audit timing to the auditees. The announcement is also addressed to the key process owners such as the general director and manager of audited unit with a copy to the CEO and CFO of Skanska CS and other Company managers if needed.

The letter should include (Appendix 1 shows the “Audit announcement memo template”):

- “Project title from the annual plan or management request
- Overall objectives and scope of the internal audit project
- Start date
- Estimated duration
- Contact details from the internal audit team“³⁴.

Furthermore, after the announcement letter, the initial data request is to be planned in order to be prepared to begin a fieldwork (Appendix 2 shows the “Information request memo template”). The information lead to formulate the audit approach and scope as well as to prepare a detailed testing. The received information includes:

- “Background details on the BU’s operations, goals and objectives,
- Financial documentation, key performance measures and trends,
- Description of the information and other accounting and control systems,
- Operational process flows and description
- System report“³⁵.

³⁴ Internal Audit Manual, Internal Audit Announcement Letter

Then, the audit team carries a preliminary review of the processes. It lasts for up to 2-4 weeks. It revises any previous “internal audit reports, risk assessment, permanent audit files, management reports, policies and procedures, and governing laws and regulations”³⁶,

5.5.1.3 Scoping meeting

This meeting is considered as a firework in order to meet the auditees personally and to verify the processes. It is attended by the representatives of audited BU and covers the following areas:

- “ Explanation of information of interest for the area of audit,
- Increase IA`s understanding of the audited BU and possible recent changes,
- Identification and agreement on crucial business issues and possible risks,
- Information on overall audit processes to be carried out,
- Give the opportunity to auditees to explain the concerns.”³⁷

5.5.1.4 Planning Memo and Meeting

Planning Memo summarises the information mentioned above and is written in English and contains following information (Appendix 3 displays the “ Scope and planning memo template“):

- “Project name/title,
- Key risks taken from ORA, STAP,
- Overview of the processes,
- Audit objectives, scope, methods and approach,
- Timeline of key events such as Opening meeting, Closing meeting, Report etc.,
- Project owner,
- Audit team members and their roles & responsibilities.

The planning meeting activities include the discussion and agreement of the following items :

- Project plan and approach,
- Deliverables,

³⁵ Internal Audit Manual, Internal Audit Request Letter

³⁶ Internal Audit Manual, part: Planning & Scope

³⁷ Internal Audit Manual, part: Planning & Scope

- Budgets,
- Roles and responsibilities,
- Development of objectives for each team member.“³⁸

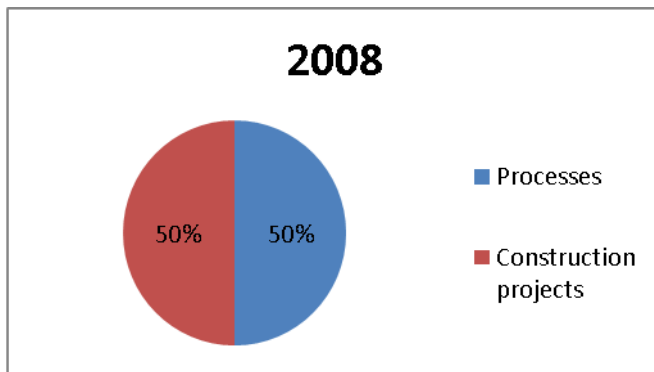
Furthermore, the another important part of Planning process is monitoring of planned audit. I have analysed calendar years (CY) 2008, 2009 and a planning for 2010.

In 2008, the internal audit department conducted 12 audits and no audit was required by the third party as well as no audit was cancelled.

In 2009, internal audit department planned to conduct 13 where 2 audits were requested by Business Unit President (BUP) and no audit was cancelled.

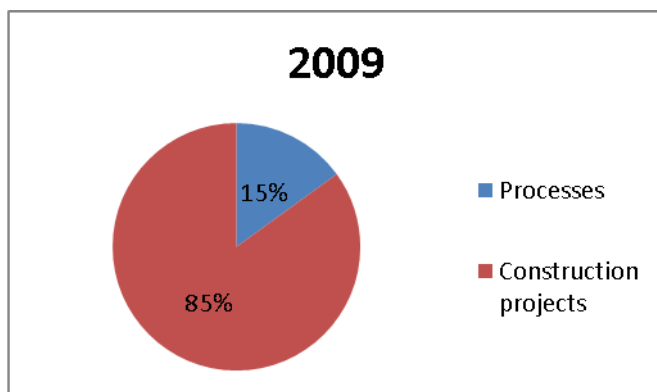
For CY 2010, the internal audit team plans to conduct 13 audits and 9 of them is required by BUP.

In the following graphs, I would like to demonstrate what were the audits focused on.



Graph 1 : Internal Audit CY 2008

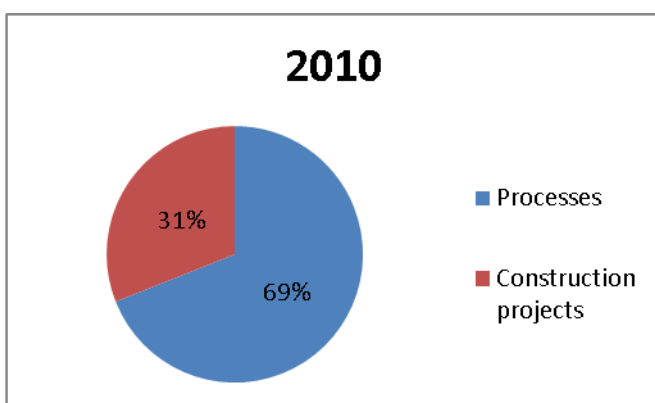
In 2008, audit of processes mainly represented risk- assessment, project development, acquisition of BU, FU procurement, forensic of inventory. Construction projects covered 3 projects from loss list and 3 projects from large list.



Graph 2 : Internal Audit CY 2009

In 2009, audit of processes mainly covered audit of travel expenses, AP/AR and construction projects covered 3 projects from loss list and 8 projects from large list.

³⁸ Internal Audit Manual, part: Planning & Scope



In 2010, audit of processes will be mainly focused on the implementation of new organizational structure and construction projects will cover 1 project from loss list and 4 projects from large list.

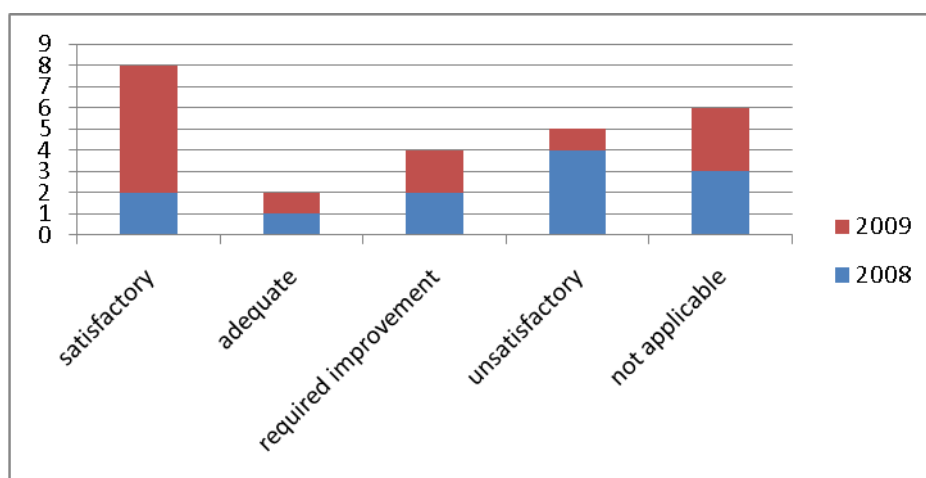
Graph 3 : Planned Internal Audit in CY 2010

When revising the usage of plans, I have found out that in 2008, the internal audit team used the annual plans. In 2009, quarterly –based plans were used and it was flexible in case of the unplanned request. In 2010, the audit team has prepared the annual plans (9 projects requested by BUP), later 4 current projects (1 project is a local loss project, 3 projects from large list).

When creating an annual plan, the internal audit team uses the risk evaluation based on the conducted audit, continual monitoring of the company, the requirements of Audit Committee of Skanska AB, projects from loss list and large list, the requirements of BUP.

Internal Audit team dedicates 70 % of its activities for planned activities, 15 % for unplanned activities, 10 % for education and 5 % for administrative work.

IA also prepares a monitoring table called “findings table“ and “follow – up table“. The results are summarised in graph 4 below.



Graph 4 : Results of Internal Audits in CY 2008 and CY 2009

From graph 4, we can see that the results of audited projects were mostly satisfactory and moreover, in 2009 the number increased compared to 2008. In 2008, there were mostly unsatisfactory results of audited projects and the number was much higher than in 2009. There exists a balance among projects which are adequate and required improvements in both years.

When planning, the activities are dedicated to the ORA, the correctness of figures in ORA, current financial situation, the accuracy of documentation and everything needs to comply with Skanska strategy “5 zeros”.

Overall, the process of planning represent for Internal Audit department 5 % of its all activities.

The Internal Audit department reports to Audit Committee Skanska AB

5.5.2 Preparation

The preparation phase takes place before each audit and it normally lasts for 2 weeks. The efficiency and success of this phase is dependant on the accuracy of the planning phase and as well as the administrative and professional preparation. During of which, the subject and the goals of a particular audit are specified. It also strongly depends on the cooperation between an audited unit and IA department, meaning that IA receives all required documents in agreed time, quantity and quality.

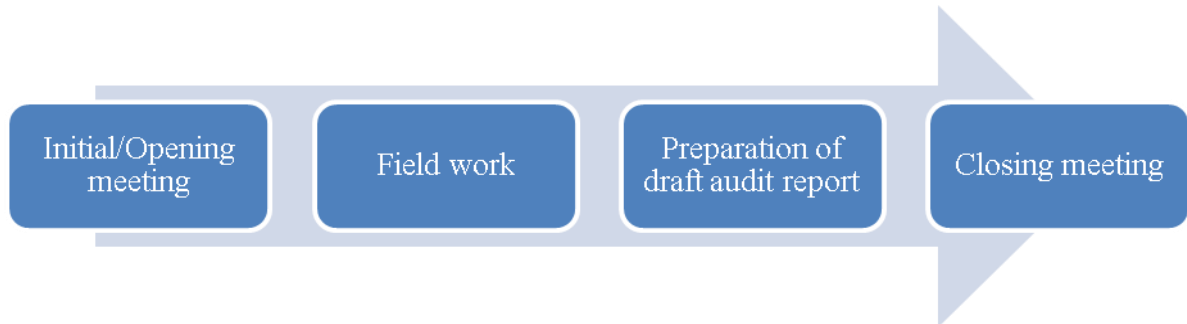
During preparation, IA sets the size of representative sample, personal and time capacities. Internal audit may also verify the past audits and their results in order to identify the areas of his interest. He takes into a consideration the potential risks and other controls. He also consults other resources which might be suitable for the particular audit such as reliable open – source documents, Skanska internal directives for particular processes and He may formulate some assumptions on auditees and wait for their confirmation or refusing in an execution phase.

Overall, the preparation phase represents approximately 80% and the execution phase 20% of internal auditing. The preparation phase lasts at least 3 weeks after delivery of all required documentation.

CAE claims that it is very significant phase as it represents the base for the other phases. The biggest obstacle is that the auditor needs to be very precise and needs to concentrate on the details.

5.5.3 Execution

This phase takes places physically at the audited unit and consists of several steps which are graphically displayed in following picture.



Picture 14 : Internal Audit Execution

5.5.3.1 Initial meeting

The main objective of the opening meeting is to meet personally with the auditees such as audited manager and direct reports, key employees associated with the audited processes and to present an audit team.

Secondly, the acknowledgement about the IA agenda which covers the confirmation of the intended objectives and scope of work, the overall audit approach, timing, and individuals assigned to the project. Furthermore, how and when the results of the audit will be reported and communicated, the opportunity for management to communicate any areas of particular concern which were not identified before and might have an impact on the scope of the audit. Then, the “project logistics“ and other practical arrangements such as the availability of the employees during audit.

It should be clear to the management of the audited unit that it is their responsibility to keep the audit team well informed and provide up - to - date information. Expectations of both parties should be discussed as well.

As execution phase requires unrestricted access to all documents, records, functions and employees, the audit team should clearly communicate it to the auditees.

During meeting, the audit report process should be also described to the management. As well as to it should be explained that their comments will be required for the completion of the audit and their responses will be included in the final report.

5.5.3.2 Fieldwork methodology

The main aim of the fieldwork is to verify whether the objectives are full – filled, the identified risks are being monitored and managed, law – abidingness,

Fieldwork covers the accumulation of documentation and evidence in order to create a statement of opinion and make necessary recommendation. “This phase covers the controls evaluation, controls testing, potential substantive testing and the formulation of findings.”³⁹

“At the planning stage, the internal auditors evaluate vulnerability to the exposures from risks, during execution they make a tentative evaluation of the adequacy of the design of controls when gaining an understanding of the controls in place; then as the internal controls are tested, they evaluate the strengths and weaknesses of the system of controls in place are adequately designed and are effective to protect against the risks identified”⁴⁰

Furthermore, it is inevitable to understand and review the audited process which normally consists from several transactions. It covers the transactions initiation, record, authorization, processing and finally the reporting. The paper documentation is required as well and it enables to verify the reliability of analysed data.

In order to evaluate the processes and data, the internal auditors in Skanska mainly use 3 software applications.

Firstly, software called CONBID is mainly used to verify the processes applied during tender call process when suppliers and sub-contractors are being chosen. Skanska Internal processes state that this process should be fully - automatic in order to prevent any fraud behaviour meaning that the most preferable supplier is chosen. Each supplier needs to comply with the Skanska processes and must undergo an approval process in a bidding process. The internal auditors examine whether the suppliers or sub-contractors have been put into the system manually or by a system itself. And when found that the supplier was chosen manually, they are able to detect the owner and discuss it.

Secondly, whole SKANSKA CS (since January 2008) uses SAP ERP. It is an application used for systems, application and products in Data Processing. It means that all processes such as accounting, finance, procurement, project overviews, and other managerial tools are displayed and can be traced. The users can clearly and easily verify all project documentations, the responsible owners etc. It is very effective and helpful tool for the overall audit controls as well.

³⁹ Skanska Internal directive, Internal Audit Manual

⁴⁰ Quoted from Skanska Internal directive, Internal Audit Manual

Furthermore, during any audit project, the data are requested from the auditees. Through another software called ACL⁴¹ (Audit Command Language), the auditor is able to test the data. It is a data extraction and analysis software used for fraud detection and prevention. It normally tests the whole set of data rather than just a sample. Data are exported to the tables and output is a statistics. The tests are focused mainly on Accounts Payables (AP) and Accounts receivables (AR), Purchase Orders (PO). The auditors revise for example Suppliers Turnover, Stratification Pay Days, Classification on Payment conditions, Classification on Accounts Keys on AP and AR.

Moreover, internal auditors at Skanska also use other methods such as:

- Interviews with the auditees or with those who are directly influenced with the audited processes
- Examination of documents such as Financial plans, AR, AP, contracts on project, financial assurance, Cash flows, Balance sheet, Profit & Loss statement, Costs and billing processes
- Flow diagrams, comparison and mathematical methods

All evidences collected must have the complete information to enable the internal auditors to follow the process such as what was done, when and by whom. As well as to understand the conclusions reached. The evidences might be the original documents which are signed and if they are not available, there should also exist the copies of the documents. Then, there is a direct evidence or proof by a manager.

All findings are continuously recorded in order to create a sufficient base for audit findings and recommendations.

If an internal auditor detects a fraud, s/he immediately informs the Chief Audit Executive of the BU. The CAE consult it with SVP GSIAC Skanska AB and then informs the auditees and furthermore he reports it.

5.5.4 Wrap Up – Closing meeting⁴²

A closing meeting is an important part in order to discuss findings, related recommendations, action plans and management responses with other comments. It should prevent from any misunderstandings or misinterpretations, by giving the opportunity to an audited unit to explain and clarify the information and to express their point of view on the findings, conclusion or other recommendations.

⁴¹ [http://en.wikipedia.org/wiki/ACL_\(software\)](http://en.wikipedia.org/wiki/ACL_(software))

⁴² Skanska Internal Directive – Internal Audit Manual

It is inevitable that the closing meeting is attended by the auditees' management and its direct reports. It is usually conducted the last day of the fieldwork. Later on, the draft report is issued within 1 week after the closing meeting.

5.5.5 Reporting

The results of audit findings should be effectively and critically communicated in order to achieve internal audit mission. The results are communicated on time and the information should be accurate, clear and consistent. If there are any weaknesses identified, they should be communicated without any delays to the auditees as the internal audit must fully report the risks exposures.

There exists a draft report and a final report. A draft report is prepared during the execution period and should be discussed with the auditees.

Each finding should include a root cause analysis and be evaluated according to the severity of a risk exposure.

Skanska Internal audit reports have unified form and contain the following information:

- Audit objectives, Scope and Methodology
- Executive summary about the audited project
- Summary of Audit findings & Recommendations
- Rating of Audit findings

In executive summary, there are some background information on an audited project, graphical description of the structure of the project, key financial data and the comments to the financial performance and the conclusion.

Part "Summary of Audit findings" contains the overview of the identified problems. Each finding is described in observation section with the particular context and with possible impacts, and then there are mentioned risks and recommendations. Management of an audited project has up to 14 days to comment. It can either agree or disagree with the audit findings and comment it. The, they should altogether agree on the most suitable action plans in order to help to improve the current situation.

Furthermore, the internal auditors agree on the rating of each audit finding. It can be classified as A, B or C where there is a significance defined as a critical, important and finally

minor one. Then, the overall rating of an audit is reported as satisfactory, adequate, requires improvements or unsatisfactory. See appendix 4.

The final report is distributed to the managers for particular of audited project and the Company Business Unit President and in a copy to the agreed representatives of Skanska AB.

5.5.6 Monitoring and Follow up

It is a last phase which is crucial part in order to support and reinforce the Internal Audit follow – up procedures. It is inevitable to assure that the outcomes are achieved and the results are monitored. Management should do the follow – ups and provide Internal Audit department with updated information.

Internal auditors monitor the status of the action plans of issued audit reports. CAE should reports regularly, normally 4 times per year, the status of audited projects and their action plans.

5.6 Practical cases

Now, I would like to involve some more practical cases which i had the opportunity to be involved in during my internship in the Internal Audit department at SKANSKA CS.

Fist described project is the project on the “Loss list“ (as explained previously) of the Skanska group.

Second project describes the audit of processes for Accounts Payables and Accounts receivables.

5.6.1 Practical Internal Audit Case 1⁴³

The internal audit for this project was requested by the BU management. It is a construction project of two highway bridges.

The objectives of this audit were to evaluate and revise:

- The effectiveness of project operations and established internal control mechanisms in order to be able to support Management’s objectives in its achievements
- The applications of law, regulations, internal directives and other guidelines in order to achieve the implementation of best practises

During audit, the internal auditors specified the most suitable areas of their interest in order to achieve the audit’s objectives. Such as:

- The revision of processes related to contracting (calculation, contract...);
- The revision of project administration, including progress billing, PRP (Project review preparation), costs control, and guaranties;
- The revision of purchasing process including selection and evaluation of subcontractors.

5.6.1.1 Audit process

The audit team consisted of 2 team members, the CAE and internal auditor. The audit work was conducted as described previously see part 5.5.1 Planning and 5.5.3 Execution.

The audited period was from July, 2007 until March, 2009.

⁴³ Information used from Internal Audit Report BU Skanska CS a.s. – CZ_2009_HighwayD1, Company Confidential report

The CAE requested the adequate documentation by firstly announcing the internal audit by sending an audit announcement memo to the audited BU six weeks in advance. And the audit unit did have 4 weeks time to collect and deliver the requested documentation. The documentation was delivered electronically by the email and CD, as well as in paper form. The materials which were requested by Audit information request memo covered:

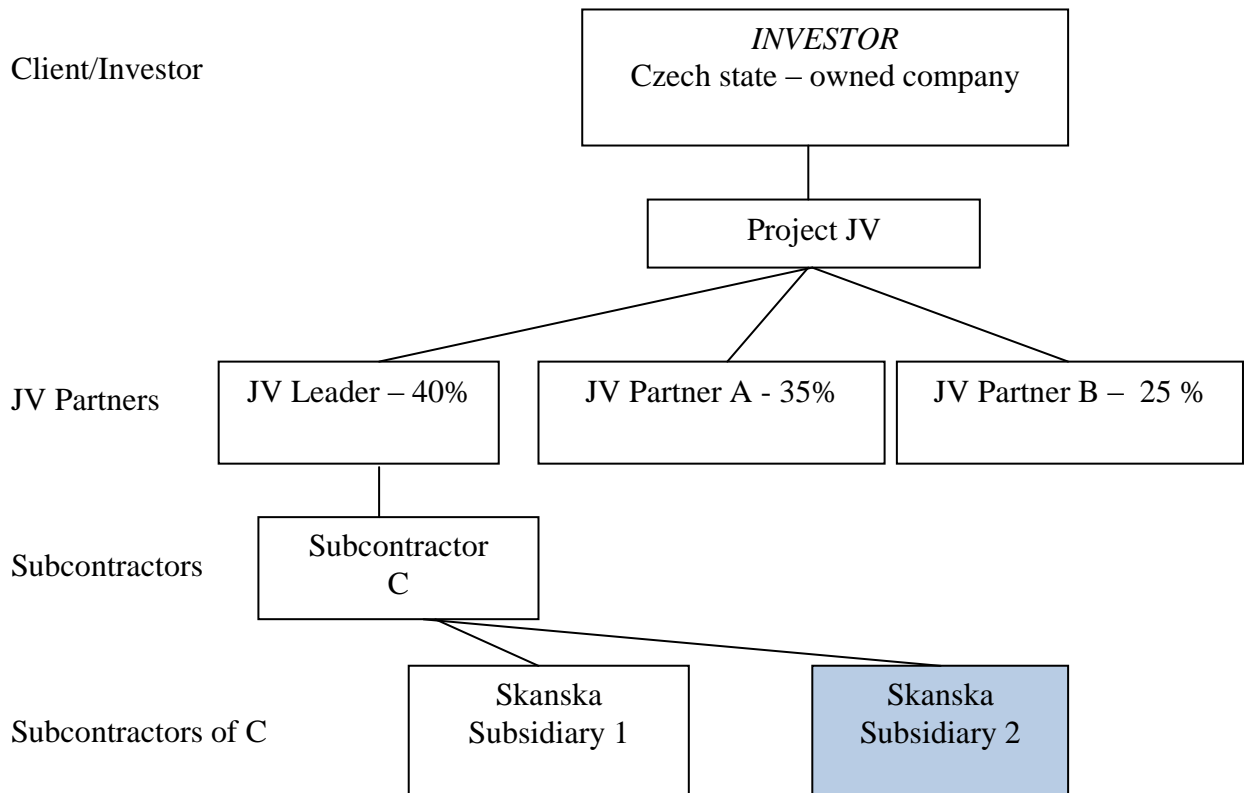
- ORA
- Statement for the execution of a project
- Organizational structure
- PRP
- Project Planning
- Costs calculations + history
- Tender calculations with current data
- Cash flow
- Construction records
- Documentation explaining budget change
- Information on completed percentage of construction
- List of sub – contractors (insurance, bank assurance, contracts, tender records)
- Compliance with the ethical code

When documentation was delivered, the auditors had 14 days to prepare for a fieldwork. Actually, the audit team had also the opportunity to verify the construction before in order to prepare itself for IA. Internal auditors revised the documents.

Then, actually internal auditors interviewed personally individual responsible persons at audited Skanska DS. The other methods applied cover the comparison, observations and financial and operational analysis. It corresponded to the parts mentioned in Planning and Execution phase and concerning the sampling, the statistical ACL tests were used. The subcontractors were revised in Conbid.

The fieldwork lasted for one week and the draft of final audit report was written. The draft report was consulted with the management and other responsible persons such as project managers, estimators, and head of bidding or controllers. The audited unit had 2 – 4 weeks to deliver their final comments before sending it out to Skanska AB and Business Unit President and CFO of Skanska CS.

For better understanding of the project audited during CY 2009, I use the illustration in the picture 15.



Picture 15 : Organization of project

The contract between JV Leader and its subcontractor C was for the construction of 3 objects. And later on, the subcontractor C (C) subcontracted 2 of these construction objects to Skanska Subsidiary 1. It has generated the net profit to the subcontractor of 10 mil. CZK. And then, Sub.C has also subcontracted the third construction object back to Skanska Subsidiary 1 which has generated to Sub.C a profit of 1 mil. CZK.

5.6.1.2 Executive project summary

Background

The project is a sub – project of other project which was audited previously with the rating as *Adequate*. Subcontractor C made a calculated profit of 11 mil. CZK and moreover, the responsibilities and the risks were transferred to Skanska subsidiary 1 and Skanska

subsidiary 2. Then Subcontractor C became a client of Skanska Subsidiary 2. And Sub.C is a one of the main competitors on the market.

The contract, which between C and Skanska Subsidiary 2 was a negotiated price contract. Meaning, the partners agreed that the construction work will be invoiced according to real quantity and unit prices in correspondence to budget calculations – which is in contract's appendices.

Finally, the constructions works started 2 months later that agreed and concluded in the contract (originally June 2007).

Problem definition

When revising a key data, the internal auditors found out that the tender margin as per ORA was 7 % and actual margin was negative. Then, the project had a negative cash flow of – 15.1 mil. CZK and was at completion rate of 75,2%. Heat Map Risk Zone was green. And when the internal auditors queried GSIAC, who has been to the project site believed that the plans to complete the constructions on time are realistic. So, overall the project was in a loss.

The internal auditors needed to find out the reasons for poor financial performance and Secondly, the internal auditors needed to find out why the Subcontractor C was chosen and then it subcontracted Skanska Subsidiary 2 and Skanska Subsidiary 1? What was its role in whole process?

5.6.1.3 Comments on financial performance

The loss of project was ,up to date calculated, - 13 mil. CZK, even though it was originally calculated with the profit of 7% of the turn – over of the project.

5.6.1.4 Audit Findings

When revising the documents and carrying out the fieldwork, the internal audit team has agreed the IA findings are critical – rated as A. More specifically, they estimated that :

The summary is displayed in Table 1:

<i>No.</i>	<i>Audit Findings</i>	<i>Rating</i>
1	Contract price was undervalued.	A
2	The contract was signed even the Skanska 77 had not enough technological equipments.	A
3	Actual costs of the project were not under effective control.	A

Table 1 : Audit Findings in Practical Case 1

Now, I would like to briefly explain why the internal auditors came to these findings.

Finding n.1 was that the contract price was underestimated. More specifically, some particular costs were undervalued such as the labour costs which were actually nearly 4 times bigger than originally calculated in tender price.

Labour costs were the greatest constrain as it was sub - contracted to Sub.C as Skanska subsidiary 1 did not have enough labour force available for that period of the project. There was a wrong calculation formula used for calculation of worker salary.

As well as the costs of machines and other technological equipment rose by 17, 6 %. The key problem was that no provision concerning valorisation of unit prices was concluded in the contract even though it is common for this type of contract. Furthermore, inflation compensation was not included in the tender price neither.

The estimated risks represent the critical deficiencies in internal control in tender and costs calculation processes and results in severe financial losses.

The following recommendations were made:

- To assure real construction's costs are in contract price
- Availability of all necessary information to employees – for calculations in time
- Inclusion of a risk contingency in the contract price for probable risk events
- Clear approval procedure for sales price
- Implementation of PRP for complex tender

Management agreed with this finding and commented it as following, see Table 2 :

Management Comment
1. Error in calculation by approx. of 50 % for labour and machine costs
2. High fluctuation of a site manager
3. Increase of input costs such as concrete armature costs and labour costs
4. Changes in realization documentation of construction towards sub- contractors
Action plan
The audited BU estimates the changes in overall amount and believes to have it submitted to the higher contractor. They expect the alterations in the amount while being already involved in the calculations (counting a lower amount)

Table 2 : Management comments and Action plan for finding n.1 Practical Case 1

Finding n.2 was signed even though Skanska subsidiary 2 did not have enough technological parts for realization of constructions. The contract starting date did not correspond with the actual starting date. The reason was the unavailability of machine and other technological equipment between delay period. The project execution was actually cut by 4 months and finally Skanska subsidiary 2 needed to rent the external equipment for extra costs. It resulted in higher labour costs as more external workers were employed in order to reach the completion date.

The estimated risks represent the critical deficiencies in internal control in tender and costs calculation processes and results in severe financial losses and may create a negative image of Skanska group.

Management agreed with this finding and commented it as following, see Table 3 :

Management Comment
1. Shortage of machinery was caused by the usage of machinery at other constructions, even though at the time of signature of contract, there was a machinery available.
2. Construction did not have the highest priority in comparison to other constructions
3. Profitability of construction was not considered as an issue
4. PRP was followed
Action plan
The audited BU wants to put higher attention to the calculation creation as well as before a deliver of its tender offer. They would like to involve more Project and Site manager during a preparation process.

Table 3: Management comments and Action plan for finding n.2 Practical Case 1

Finding n.3 was that the actual costs of the project were not effectively controlled. When revised the application of internal processes and directives, the internal auditors found out that the project does not report the forecasts on a quarterly basis as required by BU procedures. The costs – to – date were not available at the time of audit neither. And the final forecasts were updated more than 6 months ago. There was no availability to obtain the information on remaining costs of the project .

The estimated risks represent the critical deficiencies in internal control of the project as the final costs might be inaccurate as well as the income recognition calculated per completion percentage.

The following recommendations were made :

- To assure to update final forecasts while prepared on quarterly basis
- Currently calculated costs and the remaining costs should be the base for the estimated final costs in the percentage of completion percentage

Management disagreed with this finding and commented it as following, see Table 4 :

Management Comment
1. They control revenues and costs on monthly basis
2. The actual costs were at disposal during audit
3. Adjustments of calculation are being processed at the time
Action plan
The provided calculation is correct and corresponds to the reality as well as it covers the adjustments of 50 % of the overall amount. Moreover, the actualization of final forecast costs will be done more often.

Table 4 : Management comments and Action plan for finding n.3 Practical Case 1

5.6.1.5 Conclusion

Internal audit team agreed that the internal controls are not sufficient and requires several improvements. It was mainly estimated from the mentioned audit findings as well as when revising the contract conditions, the contract did not include any provisions about the indexation of costs even though, the client/investor calculated on it. There was also a problem when choosing the sub – contractor C and as it was manually registered to Conbid software. And the internal auditors originally estimated the fraud behaviour; however, it was approved by the investor.

However, GSIAC suggested that SKANSKA should support direct cooperation among Skanska BU meaning that when cooperating directly with Skanska Subsidiary 1 and Skanska Subsidiary 2. It would have saved 11 mil. CZK. The estimated role of a subcontractor C in this project was to provide a labour force.

5.6.2 Practical Internal Audit Case 2⁴⁴

The internal audit was part of annual plan when as described previously, Internal Audit team needs to assure that the used processes by Skanska Business Units correspond to Skanska group's recommendations and practises. The audit was conducted at one subsidiary

⁴⁴ Information used from Internal Audit Report BU Skanska CS a.s. – Accounts Payable &Accounts Receivable , Confidential information report

of Skanska CZ a.s, the company which specializes in the implementation of building structures. The objectives of this audit were to revise and ensure:

- The posted AP and AR accounting transactions are appropriately documented with proper evidence
- All payments correspond with the amount invoiced or being invoiced
- Revision of bank accounts for the payments to the supplier
- Existence of internal control and other processes and its effectiveness and sufficiency for any risk prevention

During audit, the internal auditors specified the most suitable areas of their interest in order to achieve the audit's objectives. Such as:

- The revision of *AP*
 - Documentation – received invoices, mailing room and scanning centre function
 - process of accounting of suppliers` invoices
 - workflow in SAP
 - process of payment
 - responsibilities and roles of the accountants/approvers/financial director
 - sampling from ACL tests for potential over- payment or double payment
- The revision of *AR*
 - Documentation –issued invoices
 - Cancellation of the issued invoices and the reasons
 - Authorization for issuing the invoices and the corresponding process

5.6.2.1 Audit process

The audit team consisted of 3 team members - the CAE, internal auditor and internal auditor trainee. The audit work was conducted as described previously see part 5.5.1 Planning and 5.5.3 Execution.

The audit covered the period such as Q1 and Q2 of CY2009. Internal audit was announced by the CAE by sending an audit announcement memo to the audited BU , at least six weeks in advance. The audited unit had at least 4 weeks to deliver the required information and documentation. time to collect and deliver the requested documentation. The documentation was delivered electronically by the email and the invoices and other contracts and directives

were controlled during fieldwork. The materials which were requested by Audit information request memo covered:

- Organizational structure of a subsidiary (Management and its subordinates, structure in the economic/accounting department)
- Statement of statutory auditor
- Statements of the reports from the financial office
- List of members of Board of directors
- List of members of Supervisory board
- Up - to - date Balance sheet and P & L statement, CF statement
- Other relevant documents for internal processes such as Internal directives, Job description and competences of employees in economic departments, Directives for handling of invoices etc.
- Invoices of AP/AR and relevant documentation such as contracts, purchase order and delivery lists with particular approval of process in workflow

Actually, the BU was already well – known to the audit team as they have already audited it for other project in CY2009. Audit team has revised the requested documents and

By ACL program, the CAE generated the statistics for sampling. The fieldwork lasted for one week and the draft of final audit reported was written . During fieldwork, the following audit techniques were used : interviews with particularly responsible employees, observation of processes in flow of AP/AR, diagrams and scheme drawing. On the last day of the fieldwork, the draft report was consulted with the management and other responsible persons such as Head of Financial/Economic department and Accountants. The audited unit had 2 – 4 weeks to deliver their final comments before sending it out to Skanska AB and Business Unit President and CFO of Skanska CS.

5.6.2.2 Executive project summary

Background

The processes of AP and AR are being operated in SAP software since 2008. The point which needs to be particularly stressed is that all invoices which are being posted as well as issued should be/and are registered in this program. All AP and AR operations were pursued by subsidiary's accounting department.

Process description

Hereby, I would like to describe what was observed when auditing the AP and AR operations and moreover, the processes applied.

a) Accounts Payable

All suppliers' invoices were received by the "Mail room" which:

- Accepts and distributes invoices according to the internal directives of Skanska CS;
- Pre-checks the supplier invoices on the basic formalities specified in the directives/contracts (mainly the signatures on the obligatory appendixes, the subject of the invoice, dates, VAT period, the correctness of information about the ordering party) and puts the delivery stamp on the supplier invoice;
- The mail room keeps a log, where the invoices received from suppliers are recorded. The invoices are thereafter sent to the Accounting department

In the Accounting department:

- The accountant checks the invoices before posting;
- The accountant does not post any invoices unless they include all appendices (delivery lists, time sheets, etc.) signed and approved by the person responsible (e.g. project manager) and pre-posts the supplier invoice;
- The accountant sends the invoices for the electronic approval through the accounting software (there exists primary – selected manually by the accountant and secondary/fixed approvers – Controlling, General, Financial director of subsidiary, Deputy of financial manager of mother company);
- The accountant posts the invoices after being approved from all parties and blocks it for payment;
- The accountant needs to check the pay due conditions as the payment terms in the system are not always set correctly (problems arise e.g. when the accountant posts the invoices including the accounting of retention bonds).
- Payments of suppliers invoices have to be approved by financial manager of company, who gives the approval for the payment to the head of the accounting department and than the head of accounting department unlocks the invoices for the payments and sent the payment while being authorised by these two parties (meaning always 2 authorizations are needed to send the payment out).

b) Accounts Receivable

Customer policy – Investor

- Audited unit has 3 main clients and other small private clients
- When entering into a competition, the clients were pre-checked by a financial director of subsidiary (the possibilities to obtain a bank guarantee was assessed and financial statements were reviewed).
-

A/R management and document flow

- The invoices were issued when the company received the approved documents from the Project manager (e.g. delivery list, handing over documents...).
- The documents were approved by the project managers and financial manager.
- The Financial director monitors the cash flows within the A/R. He mainly focuses on the due dates for payments, the retention bonds (short term, long term) and costs calculations (spending). The production manager with the cooperation of Controlling monthly recalculates the costs and expenses of the projects as well as the margin and they forward it to the Financial director.

Cancellation of the issued invoices

- The Financial director needed to approve any cancellation of invoices.

When planning and preparing for a fieldwork, the internal audit team identified some potential risks such as the potential double – payments, over-payments, invoices on AP were paid earlier than stated in the payment and contract conditions, high amount of cancelled issued invoices.

During fieldwork, the internal audit team was mainly interested in verifying its presumptions.

5.6.2.3 Comments on financial performance

Key financial data for Q2 showed that audit unit is capable to create an added value as it reaches high EBITDA and operating margin of nearly 7%. Order backlogs are actually higher than its revenues which can be interpreted as a stability of assured cash flows for future and resulting in a positive profit. Furthermore, the order bookings for future only 5 %

of current orders and it may represent the potential financial instability of cash flow in future period. Currently, the audited unit has 85 employees.

5.6.2.4 Audit Findings

When revising the documents and carrying out the fieldwork, the internal audit team agreed on ratings from important to minor. More specifically, they estimated that:
The summary is displayed in Table 5.

<i>No.</i>	<i>Audit Findings</i>	<i>Rating</i>
1	AP – Potential late payments for AP in case of retention bonds	C
2	AR – Monitoring of reasons for the cancellation of invoices issued	B
3	IT - SAP software – Access rights	C

Table 5 : Internal Audit Findings in Practical Case 2

Now, i would like to briefly explain why the internal auditors came to these findings.
Finding n.1 was that there may exist the potential late payments. The SAP software calculates the payment terms from the date of posting of supplier invoices and not from the delivery date. The accountants need to check the posting of invoice after being posted as SAP software sets the payment conditions not correctly when the transaction includes the posting of a retention bond.

The estimated risks are that the auditees can pay lately to suppliers and it can result in worsening the brand image.

The following recommendations were made:

- To Skanska CS to adjust the automatic calculation of due date in SAP software as the base date for the calculation of payment due date should be delivery date of invoice as stated in the contracts

Management agreed with this finding and commented it as following, see Table 6:

Management Comment
1. Management adopted a decision to extend the supplier's invoice maturity in correspondence to contract's terms and conditions
Action plan
Primary approvers for the invoices (such as Project Manager) confirm them in approval process in SAP by commenting on the parameters, so it corresponds with the contract's terms and conditions . Invoice due date should be assigned to the delivery date or the date of issue of the invoice.

Table 6 : Management comments and Action plan for finding n.1 Practical Case 2

Finding n.2 was the cancellation of issued invoices. 10 % of issued invoices were cancelled. The internal audit team tried to identify the reasons during fieldwork. More than 1/3 of invoices were cancelled before sending it to the client due to the administration mistakes. The other 30 % of cancelled invoices were due to the non – approved delivery lists from JV partner (however, it was already corrected as it covered mainly 1 project). For 17 % of cancelled invoices, the internal auditors were not able to identify the reasons for cancelation because of missing support documentation.

The estimated risks and effects are that the cancellations and errors may delay the sending of invoices to the client. However, it can result that the company is paid after paying its suppliers which may result in negative level of Working Capital as the period for payment of AR is prolonged.

The following recommendations were made:

- Auditees should conduct a root cause analysis for the cancellation of invoices in order to eliminate the reasons
- Auditees should archive the reasons and the approvers should be aware of it
 - The payment period for AR should be minimised for issuing of invoices to the client and is based on approval of all related documents (suc as PO, Contract with all appendices, Delivery lists)

Management agreed with this finding and commented it as following, see Table 7:

Management Comment
1. Large amount of cancelled invoices was due to 1 project which was executed in JV partnership. The partner did make the additional corrections to carried works Shortage of machinery was caused by the usage of machinery at other constructions; even though at the time of signature of contract, there was a machinery available.
Action plan
Actions were taken immediately such as that cancellation of all issued invoices must be noted down and signed personally. Moreover, all invoices returns must have a well- noted reason by writing it by email from the responsible person for the invoice return. The issued invoices must be noted down in the out – going mail records with the monitoring of the reasons.

Table 7 : Management comments and Action plan for finding n.2 Practical Case 2

Finding n.3 concerned the access user rights to the accounting software. During audit, the audit team found out that some employees had the access rights to the system that did not correspond to their job description

The estimated risks may cause that the current access rights allow to the employee the access to operations to which s/he is not eligible to. And it may result in unauthorised changes in accounting system. Such as that the employee who can create PO, cannot have the access rights to the accounting operations such as posting, modification or clearing the invoices.

The following recommendations were made:

- To ensure the proper job description – roles, duties, access rights to accounting software

Management agreed with this finding and commented it as following, see Table 8 :

Management Comment
1. Each employee has the access rights to SAP which correspond to his/her working responsibilities and liabilities
Action plan
The inspection of all employees of an audited unit will take place and the authorizations for the access rights will be modified according to the current position, responsibilities and liabilities of each individual employee.

Table 8 : Management comments and Action plan for finding n.3 Practical Case 2

5.6.2.5 Conclusion

Internal audit team agreed that the overall result of audit is adequate. This conclusion was based on several findings which were mentioned previously. Furthermore, as previously estimated, the potential over-payments or double payments were not proved. The audit team, also found out than the payment terms did not really correspond to Skanska standards, however, the financial director balances the AR/AP payments. And so far, the subsidiary did not have severe problems with its financing.

Moreover, it is important that the auditees properly define the segregation of duties for each individual employee corresponding to his/her proper job description. No violation of Code of Conduct was identified during audit.

In order to improve and optimize the costs, the internal audit team recommended and suggested sharing of services, information for all subsidiary's . It is currently being completed by Skanska CS as a part of "One Skanska" Initiative.

6 Conclusion

My Master thesis focuses on Internal Audit theoretical background and its practical implementation into the practice in a specific company Skanska where i had the opportunity to participate at different audit projects.

Firstly, I described the history of Internal Audit and i have also included the survey conducted by PwC on IA in the Czech republic. We can see that it is still a relatively new discipline and it becomes more and more popular within the companies. However, a lot of companies do not really guarantee its independence from other operations and activities. That is why, i tried to described the common and as well as different features among several other disciplines such as External Audit, Controlling, Managerial accounting, Corporate governance. And it is inevitable to understand that the internal audit is an independent, advisory, objective assurance and controlling body within the organization.

Moreover, I also concentrated on the key roles and competences of IA and as well as internal auditors. Now days, the key priority of internal auditors should be the interest in risk analysis which reflects the fast changing conditions and strategic business goals on the Czech market. In next five years, we can presume that the biggest emphasis on audit of risk management and IT security. The important role will be its role in education of employees. Furthermore, it faces the challenges of quickly developing of ethics and compliance. And it requires that the internal audit procedures get adopted. The surveys show that the higher demands will be brought in the following areas of IA: risk management, corporate governance and compliance.

In practical part of my Master thesis, I revised and compared the processes of Internal Auditing in Skanska group. Hereby, I would definitely stressed the importance of risk management and the evaluation of risks during tender approval. It is inevitable to mention that the construction business carries out several specific risks and Skanska recognizes mainly 5 top risks such as the legal, financial, technical and operational, social, environmental and ethical. The initial potential risks are firstly evaluated by the sales department and then the authorization process for the approval starts. The potential risks are classified in the map of risks and summarized in pre- ORA and ORA documentation. These materials represent the entry information for the planning and as well as preparation of Internal Audit in Skanska CS. Internal audit department prepares annual plans upon the arrangement with Skanska AB and Business Unit president. Internal Audit team dedicates 70 % of its activities for planned

activities, 15 % for unplanned activities, 10 % for education and 5 % for administrative work. According to my opinion, it represents very flexible planning, what is really crucial.

In last years, the number of conducted audits is increasing and they have the satisfactory results. Moreover, as mentioned previously, the IA planning in 2010 will mainly focus on the processes which definitely reflects the current trend and situation on the market. All together, planning and preparation phase in Skanska represents approximately 80 % of processes conducted during internal audit. There exists Skanska internal audit manual which precisely defines and describes the particulate phases and methodology.

When verifying, internal audit department is fully independent from the core activities of Skanska CS and internal audit team reports directly to Skanska AB and its audit committee.

Furthermore, I described two practical cases, the internal audits conducted during CY 2009. The result of the first practical case was not satisfactory as it was the project from loss list and finally the internal auditors found out that the originally accepted conditions were not advantageous for Skanska and the potential risks were underestimated. The second project revised the internal procedure of AP/AR and had a positive satisfactory result.

I would summarize that all conducted audit fully correspond to the prescribed methodology and procedures of Professional Practice of Internal Auditing and the AC of Skanska AB fully respects the findings. Moreover, the management of audited BU does not always agree and as well as do not respect the findings and recommendations. All findings are currently listed in the list of findings according to their importance and then they are regularly monitored according the dates for the elimination of findings. Identified findings are also the part of regular BU self- assessment, when BU needs to comment the elimination of findings. Furthermore, Internal Audit monitors whether the information provided is trustworthy and correct.

From January 2010, Skanska CS will experience the restructuring of current organizational structure.

I would suggest that as Internal Audit team has only 2 members, it may represent a potential risk for the execution of internal audits as the current members might get overloaded with the projects. It is also inevitable that IA department stays in close contact with Skanska business units in order to get another insight into the internal audit's procedures when receiving the feedback.

Finally, I would like to mention that Internal Audit department and audit units are still one company which means that it is a responsibility of all units to contribute to the positive business development of the company. That is why; the departments should have an open,

trustworthy and reliable relation in order to perform effectively. Then, the key role of Internal Audit can be recognized, such as the *prevention* - employees are awarded that they might get audited and are motivated for better performance and results, *advisory* – the internal auditors give their opinions and recommendations to management of audited units and as well as to Board of directors of Skanska CS, *independent insight* – even though Internal Audit department belongs to Skanska group, it is fully independent on the activities of Skanska CS and reports directly to Skanska AB.

I would like to also mention that my objectives of thesis were clearly described in the theoretical part where my thesis revised the important mill – stones such as role/competences of IA in the company. I would like to say that the role of IA in companies is not the easy because various researches show that there is a lack of support from top management and as well as the board of directors. However, as I have shown in provided research, the trend is positive. And its role has changed from just to audit or control to listen to internal parties such as managers and other stakeholders. And when there is a problem, internal auditors need to prove their knowledge and expertise. And they become the professional advisors. Furthermore, I also described its importance within the organization as well as concerning the cooperation with other disciplines or departments.

Skanska proved to have functioning department which can successfully conduct the internal audit projects and it was practically proved by two described cases. It also needs to struggle with internal problems when communication with audited units, however, it should be changed with new organizational structure in 2010.

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11 Appendix

Appendix 1 Audit Announcement Memo

SKANSKA	Skanska AB	101
	Our contact	
	Group Staff Internal Audit and Compliance	

Generální ředitel společnosti, Skanska CZ a.s.
Ekonomický ředitel společnosti [REDACTED], Skanska CZ a.s.
Generální ředitel Skanska CZ a.s.
Ekonomický ředitel Skanska CZ a.s.

Věc: Oznámení o provedení auditní prověrky účtů závazků a pohledávek – [REDACTED]

Vážený pane řediteli,

informujeme Vás tímto, že GSIAC provede auditní prověrku týkající se výše uvedených procesů. Samotná prověrka je předpokládána v sídle Vaší společnosti ve dnech od [REDACTED]

Vlastní prověrka bude zaměřena především na:

Oddělení pravomocí v rámci procesu,

Zda-li jsou účetní operace podloženy odpovídajícími doklady,

Zda-li uhrazené/fakturované částky jsou ve shodě se smluvními ujednáními / přijatými / vydanými fakturami,

Zda-li byly platby poukázány na správné účtu sub/dodavatelů,

Zda-li jsou nastaveny systémy vnitřní kontroly procesu,

Zda-li tyto kontrolní mechanismy efektivně pokrývají inherentní rizika prověřovaného procesu.

S dalšími informacemi nebo dotazy, týkajícími se prověrky, Vás budeme včas kontaktovat

V případě dotazů mne neváhejte kontaktovat na mobilním telefonním čísle [REDACTED]

S pozdravem

[REDACTED]

ředitel Interního auditu

CC: Generální ředitel Skanska CS a.s.
CFO Skanska CS a.s.

Appendix 2 : Audit Information Request Memo

SKANSKA	Skanska AB	1 (1)
	Our contact	
	Group Staff Internal Audit and Compliance	

Věc: Požadavek na předložení podkladů pro auditní prověrku účtů závazků a pohledávek.

Generální ředitel	
Ekonomický ředitel	
Výkonový ředitel	

Vážený pane řediteli,

ve snaze o maximální zefektivnění procesu přípravy i samotné prověrky Vás žádám o předložení dokumentace týkající se zmíněného procesu. Konkrétně Vás žádáme o následující:

1. Organizační struktura společnosti (zařazení managementu a zaměstnanců; ekonomická struktura),
2. Aktuální zprávu statutárního auditora,
3. Zprávy z prováděných proverek finančním úřadem (pakiže nějaké byly),
4. Seznam členů Představenstva,
5. Seznam členů Dozorčí rady,
6. Rozvahu a výsledovku ke 30/06/
7. Relevantní procedury k prověřovaným procesům,

Výše uvedené dokumenty dodejte prosím v elektronické formě nejpozději do

Dále bychom touto cestou chtěli požádat o podklady (faktura dodavatele, objednávka/smlouva, potvrzený dodací list, schvalovací proceduru z workflow) k prověření provedených plateb uvedených v příloze „Potential Over Payments“ pro položky seznamu # 1 – 24.

Rovněž žádáme o předložení faktury dodavatele, objednávky/smlouvy, potvrzeného dodací listu a schvalovací procedury z workflow pro položky # 1 – 20 seznamu v příloze „Potential Duplicate Payments“

Tyto uvedené podklady dodejte prosím v originálním provedení po našem příjezdu do Stamartu.

Předem Vám děkuji za Vaší spolupráci. V případě dotazů mne neváhejte kontaktovat na mobilním telefonním čísle

S pozdravem

Ředitel Interního auditu

Appendix 3 : Audit's scope and planning

SKANSKA	Skanska AB	1003
	Division	
	Group Staff Internal Audit and Compliance	

Audit scope and planning memo

Audit No.	CZ09-09
Audit area	BU Skanska CS – Skanska CZ a.s.
Object of audit	Accounts Payable and Receivable
Period reviewed	
Result of previous audit	Not applicable
Kick-off date	
Audit dates	
Closing meeting date	
Draft report sent to management	
Management response received	
Audit Scope memo issued	

Background

GSIAC is going to carry out an audit of the process Accounts Payable and Receivable.

The objectives of this audit is to ensure whether sufficient internal controls exist and are efficient to cover the inherent risks linked to the reviewed activities.

Prior Year Audit Issues

Not applicable

Key Systems

- Auditees: SAP
- GSIAC: ACL

SKANSKA	Skanska AB	2023
	Group Staff Internal Audit and Compliance	

Audit Approach and Scope

The objectives of audit are to ensure whether:

- the posted accounting movements are supported with satisfactory material evidence,
- all payments agree with the amount registered on each individual invoice,
- the bank accounts on which the amounts are paid agreed with the correct supplier bank relation,
- the payments occurred on an efficient manner,
- the necessary internal controls existed, and
- Those internal controls are efficient and sufficient to cover the risks inherent to the reviewed activities.

A) The audit activities related to the AP are:

1. Request and validate the obtained ACL files by comparing the figures of the ACL files with the official accounting figures.
2. Carry out following controls re. the selected supplier invoices (on sample basis via ACL):
 - o Amount on invoice agrees with related PO;
 - o Invoice date IT agrees with invoice date invoice;
 - o Due date IT agrees with due date invoice;
 - o Payment conditions invoice agrees with IT;
 - o Quantity variance flag put on and for how many %;
 - o Review the modification of the PO (approved – justification – etc.);
 - o The invoices was duly approved;
 - o Work-flow process was applied;
 - o How many persons approved the invoice;
 - o Was the name and position of the approving person indicated;
 - o Was the PO reference indicate on the invoice by the related supplier;
 - o Do the delivery list agrees with the invoice;
 - o Was the PO establish before goods delivery/services were rendered;
 - o No down-payments;
 - o Was the purchasing dept involved in the actual purchasing process?
3. Stratify all supplier billing notes in order to find out how many documents were send per supplier.
4. Stratify on the turnover of each supplier.
5. Classify each payment condition and find out if discounts existed.

6. Classify on supplier ref & payment condition to find out if various payment conditions existed per supplier.
7. All potential discounts were taken or not
8. Review the most important suppliers (sample of one invoice) in order to see if the related supplier granted or not a discount.
9. Reconcile the payment files with the supplier invoice file (amount paid = amount invoice, payment agrees with a supplier billing document).
10. Review the master supplier DB in order to find out if some data is missing: VAT ref., etc.
11. Find out any duplicated payment.
12. Find out any over-payment.
13. Find out any duplicated supplier invoice.
14. Find out any duplicated supplier (name, address, VAT # and bank account ref.).
15. Each bank relationship based on material evidence.
16. To each supplier agrees only one bank account reference.
17. Ensure yourself that no bank account ref. agrees to multiple suppliers (attention to factoring).
18. Review the percentage of reverse Quantity and Unit price on PO.
19. Review the correctness of the A/P documents referencing
20. Due date of the invoice = payment date (no early payments).
21. Compare the master supplier database with the billing file in order to find out any discrepancy between the bank account references.
22. Examine how many payment conditions existed at the company.
23. Examine the average payment delay.
24. Ensure yourself that satisfactory segregation of duties existed between following tasks: PO – Purchasing – Invoice posting – Quantity control and payment
25. Verify that each payment was based automatically upon the data included in the A/P IT system.
26. Who could modify the supplier master database.
27. IT protections existing in the payment – A/P IT systems.
28. How many authorizations were necessary to pay a supplier invoice?
29. Had the 'payment clerk' no access to the supplier master database and never posted any invoice.
30. The bank reconciliation process was carried out by whom, at which interval, how was it documented and approved.
31. Who carried out the posting of the bank statements?

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B) The audit activities related to the AR are:

1. Obtain an organization chart of the company;
2. Obtain a copy of the report of the statutory auditor about LY financial statements;
3. Obtain a copy of the report from potential VAT / tax administration controls;
4. Obtain the list of Supervisory Board members;
5. Obtain the list of Board of Directors members;
6. Obtain the latest account balances (B/S and P/L);
7. To describe and understand the system of Account receivables management;
8. Sales policy: sales territory, promotion actions etc.
9. To obtain all relevant procedures;
10. To check all used systems and the interfaces between them.
11. To obtain AR files and to validate them with Accounting;
12. To calculate Interco sales;
13. Customer turnovers;
14. Stratification per customer turnover and per customer invoice;
15. Classification of payment conditions, What is the standard payment condition;
16. To select the customers with more than one payment condition applied during the period under review.
17. To obtain file: customer db with credit limits;
18. To search potential duplicates;
19. To select over-credit-limit customers and to ask for formal documentation;
20. To see if credit limits are automated and who can unlock the customer?
21. To ask for the pricelist – is the price list for distribution of glass is incorporated and automated within the system?
22. Price policy, price calculation etc;
23. To check on sample basis if the unit price on the invoice agrees with the price list;
24. To see if there is a warning message if the price offer lead to a negative margin;
25. To select invoices (better items on the invoices) with a negative margin and to calculate the loss during the period under review;
26. To check the discount policy. Who can give and approved the discounts. To see which types of discounts are applied (based on turnover, monthly, year-end bonus etc...);
27. To check document flow and which documents are used in the AR management;
28. Who is approving the documents (order, delivery list, CMR, invoice);
29. To check on sample basis if all necessary documents exists and are duly approved;
30. To obtain Credit notes procedure and to see who can issue and who can approve the CN;

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31. To select the highest credit notes and to see the reason and to follow up all formal aspects;
32. To select negative invoices (cancellation of the invoice) – to ask about the reason;
33. To check if there is no bad segregation of duties (e.g. price determination AND maintenance of customer database etc.) and to see if there is no conflict of interests within the AR management.

Key Internal Risks

- Segregation of duties is not properly settled,
- the posted accounting movements are not supported with satisfactory material evidence,
- payments disagree with the amount registered on each individual invoice,
- the bank accounts on which the amounts are paid disagree with the correct supplier bank relation,
- the payments incurred on an efficient manner,
- Any internal controls existed, and

Resources

Internal audit team: [REDACTED] Katarina Roháčková

Key Client Contacts:

Resources and responsibilities

Internal audit team:

[REDACTED] [CAE] is responsible for:

- Audit announcement,
- Audit scope issuing,
- ACL tests,
- Selection of items for samplings,
- Sending of the draft to auditees,
- Final report issuing,
- Communication with Skanska AB,
- Communication with BU management,
- Supervision of the team.

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.....[ZM] is responsible for:

- Collection of related external/internal procedures and rules,
- Valuation of those rules (aging, validity, comparison of internal and external rules),
- Performing, in conjunction with CAE, of sampling of,
- Proper documentation of all memos and results,
- Thoroughfare of all findings results within the whole audit team,
- Communication of all suspicion of potential frauds primarily with CAE than some action will be taken,
- Presentation of all audit findings to CAE immediately when they will be proved,
- Presentation, in conjunction with CAE, of results to auditees,

Internal rules

- This scope is mandatory for the whole audit team;
- To conduct the audit in accordance with The International Standards for the Professional Practice of Internal Auditing;
- To follow Internal audit manual;
- To share all information related to the audited process within the internal audit team (verbally, e-mail, common share);
- Concealment of findings and/or willful default that could lead to audit conclusion distortion will be evaluated as breach of working discipline.
- All audit's results should be supported by relevant physical documentations that led to the results in order to make it readable and conclusive for anybody;
- All supporting documentation should be stored in the file and should be easily retrievable by anybody.
- A certificate of dispatch as well as reception should be activated for all e-mails that will be sending to auditees. E-mails should be printed for documentation when certificates are ratified (at least dispatch).
- Continuous audit results must not be provided to disinterested subjects.

Appendix 4: Definition of audit findings ratings

<u>Rating</u>	<u>Significance</u>	<u>Definition</u>	<u>Characteristics</u>	<u>Remediation</u>
A	Critical	A fundamental control or accounting weakness, which requires immediate attention of the BU management and priority action for resolution.	<ul style="list-style-type: none"> • Critical or systemic deficiencies in internal controls that could result in significant financial loss, regulatory exposure or damage to the reputation of the firm. • A repeat audit finding or a failure to sustain previously implemented corrective measures. • Substantial noncompliance with management's policies, procedures, directives and regulatory requirements that could result in material financial loss or damage to the reputation of the firm. • Errors and irregularities and/or noncompliance with GAAP that would be material to the financial statements and not be detected in a timely manner by employees in the normal course of operations. 	Findings must have at least a temporary fix completed, and a definitive plan put in place, within 30 days of issue being identified.
B	Important	An issue of substantial importance, which requires the immediate attention of the responsible, line management and an agreed program for prompt resolution.	<ul style="list-style-type: none"> • Weaknesses in processes and/or internal controls that have the potential for financial loss, regulatory exposure or damage to the reputation of the firm. • Noncompliance with policies and procedures. • Internal control weaknesses that are not individually significant, however, in the aggregate, may represent a general weakening in the overall control environment. • Management and control procedures are put in place in an unstructured manner in order to deal with problems that arise. 	Findings must be corrected or mitigated, or a definitive plan put in place, within 60 to 90 days of being identified.

C	Minor	An issue, which does not necessarily warrant immediate attention but which should have an agreed program for resolution.	<ul style="list-style-type: none"> • Minor impact from a financial perspective, but will not materially affect the results. • Weakness in internal control but there is a compensating control within the process. • Suggestion to improve efficiency or effectiveness of operations. 	Findings must be corrected or mitigated, or a definitive plan put in place, within 90 to 120 days of being identified.
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<u>Overall rating</u>	<u>Definition</u>	<u>Characteristics</u>
Satisfactory	The audited entity was found to have an overall strong control environment with minimum weaknesses, significant number of mitigating controls in place and minimal risk of financial misstatement, loss, or damage to the reputation of the Company.	For an area to receive this rating, management and the staff must have a good knowledge of the business risks and internal controls. Internal controls must be effective in relation to the inherent business risks of the area. Only minor control weaknesses may exist, some, which might be of housekeeping nature. Area/function is well controlled; however, there is an opportunity to enhance the effective, efficient and economical use of the firm's resources. The internal audit report may contain recommendation for improvement for which management should take corrective action.
Adequate	The audited entity was found to have an adequate control environment. No high risk control or accounting weaknesses were found during the audit that, in internal auditor's judgment, should result in significant financial misstatement, loss, or damage to the reputation of the Company.	For an area to receive this rating, management must be control conscious. Internal controls are mostly effective in relation to the inherent business risks of the area. Some control weaknesses may exist in few areas. None of the weaknesses, however, should be pervasive to the business as a whole or have the potential to result in significant financial misstatement, loss or damage to Skanska CS reputation. The internal audit report will contain recommendation for improvement for which management should take corrective action.

Requires improvement	A few fundamental control or accounting weaknesses were found during the audit that, in internal auditor's judgment, could result in financial misstatement, loss or damage to the reputation of the Company.	Certain aspects of the controls environment need improvement to 1) ensure adequate internal controls, 2) financial statement accuracy, 3) provide adequate protection to the Skanska CS assets, 4) avoid damage to Skanska CS reputation. One or more significant deficiencies in control systems, as well as repeat audit comments may exist. Weaknesses noted may be material to the business as a whole and create the potential for financial misstatement, loss, or reputation risk. In addition, weaknesses may not be individually significant, however, in the aggregate, may represent a general weakening in the overall control environment. Senior management must provide immediate attention, sufficient resources, and follow-up to ensure timely correction of weaknesses.
Unsatisfactory	Several fundamental control or accounting weaknesses were found during the audit. That, in internal auditor's judgment, could result in significant financial loss, regulatory exposure or damage to the reputation of the Company.	Critical or systemic deficiencies exist in internal controls that cause exposure to significant financial misstatement, loss, and/or damage to Skanska CS reputation. Exposure is material to the business and Company and may result from unidentified business and control risk, serious problems with operating systems, unreliable management information as a basis for managing key risks, or substantial non-compliance with critical policies and regulations. Senior management must be immediately and extensively involved, and the exposure must be curtailed promptly. This might require re-deploying resources and implementing interim solutions until longer-term changes could be made.