



What does a Chief Financial Officer expect from Internal Audit?

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Peter Voser was appointed Chief Financial Officer and Executive Director of Royal Dutch Shell plc on 20 July 2005.

From October 2004 up to the formation of Royal Dutch Shell plc Peter was Chief Financial Officer of the Royal Dutch/Shell Group of Companies and a Managing Director of The “Shell” Transport and Trading Company plc

From March 2002 until September 2004, Peter was Chief Finance Officer (CFO) and Member of the Group Executive Committee of the Asea Brown Boveri (ABB) Group of Companies, based in Switzerland.

From August 1982 to March 2002 Peter was employed by the Royal Dutch/Shell Group of companies in a variety of Finance and Business roles in different countries.

After moving back to London from Chile in early 1997, Peter became the Group Chief Internal Auditor. In 1999 he was nominated as CFO in Shell Europe Oil Products before becoming CFO of the Global Oil Products Business (early 2001), and a member of the Oil Products Executive Committee.

In April 2005 he was appointed to the Board of Directors of UBS AG.

In November 2006 Peter was appointed a member of the Swiss Federal Auditor Oversight Authority.

Peter graduated in business administration from the University of Applied Sciences, Zurich, in 1982.

He was born on 29 August 1958 in Baden, Switzerland, and is married to Daniela. They have two daughters and a son.

In this speech, delivered for the Institute of Internal Auditors, Peter Voser discusses the role and core responsibility of Shell's 250 auditors, which is to provide Assurance, Insight and Recommendations to the CFO and the Audit Committee. He also presents his ideas about the future of Shell's Internal Audit function, explaining why Shell's IA-Unit will in the coming years be more active in more areas of the business. He discusses four of these "growth areas" in greater detail: Integrity, Information Technology, Technical Auditing of Oil and Gas Reserves, as well as the growing web of External Partnerships. Peter foresees that doing a stint in Internal Auditing will increasingly become a requirement for future Shell leaders.

It is said that internal auditors are accountants without a sense of humour. The cartoon character Dilbert, that sage of office politics, even tells us Internal Audit is a paradise for sadists.

My vision for Internal Audit is slightly different . . . no, not as a fool's paradise . . . but as a meeting point for open-minded and talented people, with a global perspective and definitely also a sense of humour.

Internal auditors are increasingly seen as the custodians of corporate governance and integrity, as the ones who reduce the risk that the Enrons and Worldcoms won't happen again. And some internal auditors have had their role strengthened by a potent compliance weapon: the Sarbanes Oxley Act.

So, perhaps the first thing you as internal auditors should audit is your own image.

Being consciously competent

Before I tell you what a CFO expects from Internal Audit, let me draw an analogy. Think of the difference between an inexperienced and an experienced driver. The first, of course, will more likely make mistakes than the latter. The experienced driver knows every twist and turn of the daily commute to work . . . and can afford to relax a little. Or so we think. But the danger for experienced drivers is to get so relaxed that you find your thoughts drifting off at 120 kilometres an hour, particularly when you're tired . . . and isn't that when the really big accidents tend to happen?

Something similar takes place in a work environment. Becoming habituated to processes and procedures is in itself a good thing – it helps us to notice situations that are

out of the ordinary. The downside is that it becomes more difficult to stay focused, particularly during repetitive processes and tasks. Being "unconsciously competent" – that is, competent but not alert - can be especially dangerous in high-risk areas of our business, like refineries, drilling operations, and transport.

Let me illustrate that. Every day, 108,000 employees and over 300,000 contractors work for Shell in operations around the world, not to mention those who have, in turn, been subcontracted by contractors. You could say that, if you have over half a million people working for you every day, it is inevitable that some of them are not alert, some lose their lives or get injured. The reputation of some companies may be really damaged as a consequence of not enough focus or discipline.

Well, we believe that nothing is inevitable. Shell has a zero fatalities ambition. An "ambitious ambition", we know. And we also know we can only hope to turn that ambition into a reality if there is a strong compliance culture.

That's easier said than done. It is not human nature to automatically love guidelines and checklists. We often instinctively bristle at the idea of conforming to rules, feeling that it is bureaucratic and it delays progress.

So an important task we face at Shell is to bring that other element of human nature to the fore: the desire to be part of something bigger, something one can be proud of. Companies with strong values and principles find it easier to attract people with strong values and principles.

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This is where Internal Audit comes in. Keeping everybody consciously competent . . . all the time – that is a challenge that can only be met with the support of a strong Internal Audit function.

Shell's internal auditing function

Let me give you some of my ideas on Internal Audit at Shell . . . and how I see it moving forward in the light of new challenges.

As you may know I have started my professional career in shell Internal Audit some 25 years ago and was also the Chief Internal Auditor of the Shell Group in the 90s.

In the 1990s, Shell focused on auditing management processes. Our approach covered a broad range of high- and low-impact risks. And the favoured method of research was doing interviews. It is true that the term auditing stems from the Latin word *audire*, to listen. And listening remains important. But we have now moved significantly beyond interviews and are following the principles of “Evidence Based Auditing” – or as you all call it: “EBA”. And, in addition to our interviews and listening, and our evidence gathering, there is also a need for auditors to speak up, even when this means, as it often does, telling line managers unpleasant truths. It's like telling them their baby is ugly.

With the unification of our company into what is now Royal Dutch Shell plc, we have strengthened the Audit Committee's role and reinforced the Internal Audit function with additional financial resources and people. We now have 250 internal auditors. As before, the Chief Internal Auditor reports directly to the CFO and the Audit Committee chair. It is the CFO who is responsible to provide IA with the financial and people resources, based on a risk-based audit plan. The Audit Committee approves the plan and the budget. The Board will not approve the Annual Report until the internal auditors have had a chance to present all their reports, findings and opinions. If the CFO has a conflict of interest, the Chief Internal Auditor has direct access to the Audit

Committee. So there is clear ownership and responsibility.

At Shell, we use a centralised model for Internal Auditing.

Since we are active in over 100 countries, it is essential that we balance our investment and divestment decisions against our entire global portfolio; the same is true for supply chain management, human resources and other aspects of the business. Internal Auditing has to mirror this reality and also take a global view.

If you have a centralised model, you cannot have a fragmented Internal Auditing unit. To have sufficient critical mass, Shell's 250 internal auditors are organised in sizable teams in London, The Hague, Houston, Kuala Lumpur, Nigeria and a number of other places. This can only work if your auditors are flexible and willing to travel. As a reward, internal auditors get exposure to many different cultures and aspects of the business.

In fact, doing a stint in internal auditing will increasingly be a requirement for those wishing to take on a leadership role at Shell. This means internal auditing will consist of 20-25% professional auditors and 70-75% people who go through IA to strengthen their risk management skills.

The art of auditing involves walking the tightrope between independence and involvement. On the one hand, auditors must be able to pass judgment independently. I believe the fact that IA has direct access to the CFO and the Audit Committee helps there. But there are often moments and situations where IA is asked to be actively involved in improving processes and controls. So, in between absolute independence and deep involvement, there are many grey areas where common sense will dictate what the balance should be . . . and we cannot be absolutist.

In a very simple way, I see the role of Internal audit as providing three things:

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- Assurance – this is the primary role of Internal Audit and is what helps a CFO to sleep at night!
- Insight – the auditors’ insight improves my oversight! - because they can approach the same issues from a different angle.
- Recommendations – Internal audit can share its expertise on control and best practices when they identify situations where the controls infrastructure needs improving.

A similar kind of balance between independence and involvement needs to be struck when internal and external auditors work together. A CFO does not like paying twice for the same service. At the same time, internal and external auditors have to align their plans and sometimes work in close connection, especially in financial auditing. But again, there are no absolutes here.

New areas of responsibility

Shell’s risk-based auditing model has so far concentrated on two areas: Business/operational risks and controls, and financial risks and controls. These remain crucial, but there is more to do.

Over the coming years, Shell’s 250 internal auditors will have to become more involved in more areas. Let me briefly highlight a few of these.

First and foremost, integrity is an increasingly important area. It requires auditors to continually monitor whether we have the right internal rules and regulations, and whether we have the right people. Integrity is both an ethical issue and a business issue. Unethical behaviour can damage a company’s reputation. And, reputation damage, while notoriously difficult to quantify, usually affects the business negatively.

Regulatory bodies put great emphasis on integrity and having mechanisms in place to protect whistle blowers. Last year, Shell introduced a global help line where Shell-staff can seek clarification on compliance issues, or

report unethical behaviour to our Global Compliance Officer, who will work together with Internal Audit if further investigations are necessary.

It is people who define an organisation’s cultural make-up.

So behavioural issues are part and parcel of IA’s responsibilities.

You have to do your due diligence work and this means sometimes poking your nose in other people’s affairs.

This can be a delicate task, but it is part of IA’s responsibility. After all, nowadays you air your dirty linen in public, wash it in front of a global audience of regulators, investors, analysts and journalists . . . and only take it back inside when everybody agrees it’s clean.

A second major area of attention is IT. Traditional methods of manual sampling have lost their relevance given the millions of transactions that are processed by global organisations like Shell. That’s why I am continuously challenging our internal auditors to make use of, and help develop, the full range of possibilities that information technology has to offer. Auditors with specialist technical skills should develop and test clever software packages that facilitate evidence-based auditing. They should also provide assurance over the risks relating to our use of information technology. Once IT-tools have been tested, Internal Auditing must disseminate them throughout the organisation. That way, information technology can be used to accelerate learning and facilitate networking. Indeed, I see a time in the very near future when IT will not only be a mechanism for enabling processes, but will also form part of the internal control infrastructure of the Group.

The third area relates to Technical Auditing of our Oil & Gas reserves. As these reserves are part of our financial reporting IA has a clear accountability to audit the technical assessment, the technical verification and reporting of these reserves. For this we need real reservoir and production specialists in our IA-team. A great

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opportunity for some of our technical colleges to learn more about risk assessment and risk auditing.

A fourth area of special interest is the growing web of external partnerships. Like everybody else, energy companies face an increasingly complex external environment, increasing the number of risks.

For an energy company like Shell these could include:

- increasingly challenging working environments such as in our arctic and deepwater projects;
- social and political pressure to reduce greenhouse gas emissions;
- resource nationalism;
- geopolitical tensions and regional instabilities;
- sudden changes in legislation, fiscal and regulatory policies;
- and increasing numbers of partnerships and joint ventures.

Let me say a bit more on that last one: external partnerships.

There's nothing new about working together with other Oil and Gas companies: Shell has worked with private and state-owned companies for many decades in many countries. But the partnerships increasingly involve new players. These include increasingly powerful national oil companies, whose governance requirements are set by the states that own them and many times within evolving legal and fiscal environments as well as emerging familiarisations of business ethics. Transparency as achieved by international regulators and stock exchanges are not always a must and recognised as such.

To deal with this situation we have established some clear ground rules to help Shell staff working in Joint Ventures to make certain our core values and business principles are respected. As a minimum, every Joint Venture should have a set of General Business Principles and proper corporate governance procedures to operate within internationally recognised standards.

We do not and will not compromise on our business principles. In practice, aligning on these principles with Joint Venture partners can be hard work. The same is true for areas like Health, Safety and Environment (HSE), or Diversity and Inclusiveness (D&I).

The growing web of international partnerships will inevitably bring political, legal and commercial challenges . . . which internal auditors will have to incorporate in their controls. This involves compliance issues, such as the ones I just described. It also involves providing assurances that our Joint Ventures are working well. For Internal Auditing, the proliferation of international partnerships is going to be a tough challenge to meet but also a tremendous learning experience for our IA talent.

Shell Internal Auditing in 2010

I said earlier that Sarbanes Oxley has proved to be a powerful weapon for internal auditors. I'll say a few words about the impact SoX has had on Shell, and about my vision of where Shell's Internal Auditing should be in 2010.

Sarbanes-Oxly coincided nicely with the unification of Shell to act as a catalyst for change. As we began to document our controls, we quickly realised we had far too many of them to be able to document, test, and assess them every year. That is why we decided to speed up our internal campaign to eliminate, simplify and standardise our processes and procedures.

We also realised that too many of our controls were in areas of limited importance. Obviously, you want to concentrate your efforts on key parts of the business, where the potential for errors is higher, or the impact would be greater. Concentrating your efforts on the most important risks makes it easier to manage them.

When we started our Sarbanes Oxley program three years ago, our SOX attestation was going to be based on around 50,000 controls. We have reduced that progressively and are now down to some 5,000. Whilst the other controls are still important to our

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business, they no longer form the basis of our attestation.

Complying with governance regulations isn't easy when you're a multinational company active in over a hundred countries, and listed on the Amsterdam, London and New York stock exchanges, each with their own rules. In practice, this means you seek to comply with the most stringent governance rules. This year, for the second time, we have been able to produce an annual report that meets all requirements on both sides of the Atlantic.

If I look ahead at 2010, the vision I have for Shell's Internal Auditing unit is that it delivers the highest quality Assurance, Insight and Recommendations to Royal Dutch Shell stakeholders in the most cost effective manner.

If our risk profile in the 1990s was one of many risks and many controls, by 2010 I want a much greater concentration of risks and controls. For instance, we will reduce the number of Enterprise Resource Planning, or ERP, systems to four or five. And we will have no more than 15-20 standard financial processes and approx. 3000 SoX controls.

Shell Internal Audit in 2010 will be an integrated unit. IT specialists, financial experts, legal experts and technical experts will all be working closely together to identify sources risk from within and outside of the business. Business risk audits, financial and IT audits will be conducted in an integrated way, rather than separately.

Conclusion

Internal Audit is a disciplined check on the human tendency to flaunt the rules. There is a parallel to the function the judiciary has in a democracy, where powers are separated. This means internal auditors should be people of great integrity.

Sometimes you have to throw yourself into

the deep end. But there's merit in learning how to swim before rather than after you dive in.

So, in our work, we use guidelines and checklists . . . and we identify risks and consider how to manage them, before we make our decisions. Put simply, we take time before we take action. And if our internal controls work properly, then they allow us to reduce that time, so that we can still act swiftly if an opportunity arises. Better still, we have identified risks and opportunities, long before they arise. After all, risk is opportunity

I have seen in my career both the formal and the spontaneous approach being used, inside and outside of Shell. And, without exception, the more formal approach has reaped the benefits.

Those who untangle a mess that has already been created are often the ones who make the headlines. But rewards should also go to those who efficiently execute their business day in day out, never creating a mess in the first place; to those who don't need reminding to be consciously competent.

And here too, Internal Auditors can play a rewarding role, by highlighting which business, units and people manage risks properly, while grabbing opportunities to move the company forward.

Internal auditors can be perfectionists. And I have no problem with that, because that perfectionism makes a CFO sleep at night.

But Internal Auditors should be allowed to crack a joke from time to time. Positive thinking can help people to improve their performance.

And, finally, if the moment has come to tell people their baby is ugly, do yourself a favour

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