

Board Perspectives: Risk Oversight

Ensuring Internal Audit Is Doing What Really Matters

Issue 68

Is internal audit providing relevant insights to the board of directors? Is the board doing what it can to ensure that internal audit is appropriately resourced so it can address the board's needs and expectations? Below, we discuss how the board can maximize the value it receives from internal audit.

As a profession and discipline, internal audit has had a long-standing objective of adding value and improving an organization's operations through a systematic, disciplined approach to evaluating and improving the effectiveness of risk management, control and governance processes. Unfortunately, many internal audit functions fall short of this objective.

Key Considerations

Chief audit executives (CAEs) and their functions are striving to become more anticipatory, change-oriented and adaptive, according to a recent Protiviti survey report.¹ Such behaviors are in great demand because internal audit functions must anticipate and respond to a constant stream of new challenges – from emerging technologies and new auditing requirements and standards to rapidly evolving business conditions. Many of these challenges deliver uncertain and still-unfolding risk implications for organizations.

According to our survey findings, change is the order of the day, and internal audit must keep pace. To this end, we discuss our view of what we refer to as “the future auditor.” In doing so, we acknowledge that the maturity of internal audit varies across different industries such that some of the attributes we introduce may already be common in certain sectors, such as financial services.

10 Ways Internal Audit Can Contribute Value

1. Think more strategically when analyzing risk and framing audit plans.
2. Provide early warning on emerging risks.
3. Broaden the focus on operations, compliance and nonfinancial reporting issues.
4. Strengthen the lines of defense that make risk management work.
5. Improve information for decision-making across the organization.
6. Watch for signs of a deteriorating risk culture.
7. Leverage technology-enabled auditing.
8. Improve the control structure, including the use of automated controls.
9. Advise on improving and streamlining compliance.
10. Remain vigilant with respect to fraud.

¹ *Assessing the Top Priorities of Internal Audit Functions: 2014 Internal Audit Capabilities and Needs Survey*, Protiviti, 2014, available at www.protiviti.com.

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With that said, the future auditor is a CAE who is positioned to be objective with regard to operating units, business processes and shared functions, and is vested with a direct reporting line to the board of directors. That person is able to contribute more value to the board because he or she understands the entity's business objectives and strategy and can identify risks that create barriers to the successful achievement of critical business objectives.

In addition, the future auditor is authorized to evaluate and challenge the design and operating effectiveness of the governance, risk management and internal control processes that address the organization's critical operational, compliance and reporting risks. The future auditor also creates value by making recommendations to strengthen those processes and by keeping appropriate parties apprised of unaddressed matters.

With these responsibilities and independent positioning in place, the future auditor is in a position to serve the board as a positive change agent and valued sounding board in safeguarding the adequacy and effectiveness of activities that matter most to the organization's success. To illustrate, the following are 10 ways the future auditor can contribute value:

1. **Think more strategically when analyzing risk and framing audit plans** – Although internal auditors have traditionally focused on operational, compliance and reporting issues, the future auditor thinks more strategically when evaluating risk and formulating audit plans. For example, the auditor identifies and anticipates barriers to successful execution of the strategy, facilitates the risk appetite dialogue at the highest levels of the organization, updates the company's risk profile to reflect changing conditions, and understands how new technological trends are having an impact on the company.
2. **Provide early warning on emerging risks** – While it is universally accepted that risk assessments must be refreshed periodically, the future auditor's line of sight is directed to timely recognition of emerging risks. For example, contrarian analysis can be used to identify emerging strategic risks and scenarios that could disrupt the company's business model.
3. **Broaden the focus on operations, compliance and nonfinancial reporting issues** – In terms of demonstrating sustained value to stakeholders over the long term, a singular focus by internal audit on financial controls is not enough. The future auditor's focus touches significant aspects of business operations, including IT security and privacy, business continuity and crisis management, supply chain management, operating expenditures, talent management, compliance management, and more.
4. **Strengthen the lines of defense that make risk management work** – For internal audit to serve as a viable line of defense, the future auditor evaluates how the organization establishes the necessary discipline to ensure risks are reduced to a manageable level as dictated by the organization's risk appetite. The future auditor also determines whether the primary risk owners and independent risk management and compliance functions are fulfilling their respective responsibilities as separate lines of defense. These areas of emphasis, coupled with a focus on the effectiveness of escalation processes, provide a context for focusing the internal audit plan.
5. **Improve information for decision-making across the organization** – The future auditor evaluates the reliability of the performance measures, monitoring systems, and analytic tools and techniques the organization has in place to ensure there is a family of lead and lag indicators and trending metrics to signal when disruptive risk events might be approaching or occurring. The future auditor's emphasis on improving risk information across the organization can lead to better information for decision-making used in the business.
6. **Watch for signs of a deteriorating risk culture** – The future auditor understands that a deteriorating risk culture presents a formidable hurdle to sustaining effective risk management. That is why he or she works with senior management and the board to ascertain whether any gaps against the desired risk culture exist, whether organizational changes are needed to rectify those gaps, and whether specific steps are necessary to implement those changes.

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7. **Leverage technology-enabled auditing** – Technology can help to automate ongoing monitoring of certain internal controls, track issues, and provide customized dashboards and exception-reporting capability. By using technology, the future auditor is able to devote more time and effort to building relationships and providing expertise in high-impact areas. A technology-focused audit approach facilitates the future auditor's shift of emphasis to strategic issues and critical enterprise risks by gaining more coverage with less effort, providing more analytic insight and offering early warning capabilities.
8. **Improve the control structure, including the use of automated controls** – The future auditor evaluates the control structure and identifies opportunities to eliminate, simplify, focus and automate controls. For example, the future auditor recognizes that automated controls provide opportunities for improving the transparency of the controls structure so that risk owners and independent risk management functions will have more insight as to how operating processes and critical controls are performing than when manual controls are in place. This emphasis is an important one because, according to a Protiviti study, nearly three times as many organizations plan to automate a broad range of processes and controls compared to 2014.²
9. **Advise on improving and streamlining compliance** – The future auditor applies a quality focus to managing compliance with the same fervor with which the organization often approaches the improvement of core operating processes. For example, the future auditor collaborates with the compliance management function to forge a more streamlined, end-to-end view of compliance management. This results in improved coordination across the organization of control requirements-setting, alignment of management and control activities, streamlining and integration of reporting around compliance and other risks, and a reduction in complexity and redundancy.

10. **Remain vigilant with respect to fraud** – The future auditor understands the importance of a comprehensive enterprisewide fraud and corruption risk assessment and evaluation of the robustness of the organization's anti-fraud and corruption program. For example, the future auditor deploys data mining and analytics techniques to analyze transactional data, obtain insights into the operating effectiveness of internal controls, and identify patterns or other indicators of possible fraudulent activity requiring further investigation.

While directors may not expect their company's CAE to contribute all of the above value points, they should periodically assess whether internal audit is doing what matters. Our assertion is that CAEs who embrace the future auditor vision are better positioned to demonstrate to executive management and the board the value contributed by internal audit through their comprehensive risk focus and forward-looking, change-oriented and highly adaptive behavior.

The board can facilitate this transition by articulating their expectations of the company's CAE and ensuring that person is positioned within the organization with the requisite resources to deliver on those expectations.

Questions for Boards

The following are some suggested questions that boards of directors may consider, based on the risks inherent in the entity's operations:

- Does internal audit provide adequate attention to operations, compliance and nonfinancial reporting issues?
- Is internal audit able to provide insight regarding strategic uncertainties and the organization's decision-making processes, particularly around risk acceptance, and whether the right risks are accepted by the right people at acceptable levels?
- Does the board periodically evaluate the scope of internal audit's activities and discuss whether modifications are needed in view of changes in the environment and the company's operations?

² *SOX Compliance – Changes Abound Amid Drive for Stability and Long-Term Value: Highlights from Protiviti's 2015 Sarbanes-Oxley Compliance Survey*, available at www.protiviti.com.

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How Protiviti Can Help

Protiviti is a global leader in providing comprehensive internal audit services. We work with audit executives, management and audit committees at companies of virtually any size, public or private, to assist them with their internal audit activities. This can include starting and running the activity for them on a fully outsourced basis or working with an existing internal audit function to supplement their team when they lack adequate staff or skills. Our service offerings support our clients' transition to the future auditor vision discussed in this publication.

About Protiviti

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