

INTERNAL AUDIT HOT TOPICS

# THE INTERNAL AUDIT AGENDA



IDEAS | PEOPLE | TRUST





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# THE INTERNAL AUDIT AGENDA: WELCOME

The role of Internal Audit continues to be recognised as a fundamental part of enabling and embedding good governance. As the risk landscape changes, becomes more complex, and with increasing regulation, many organisations are looking to Internal Audit to provide 'assurance' and advice as 'risk and control' experts.

This role has evolved over the past five years, increasingly to one in an advisory capacity - both protecting and creating value in the business. Whilst the exact details of the outcome of the UK Government Business Energy Industrial Strategy (BEIS) consultation are yet to be announced, it is expected this will continue to place a focus on the assurance agenda of an organisation, with Internal Audit playing a key role.

Internal Audit has an opportunity to be a leader in this assurance agenda. We are in a privileged position to look across the risk landscape of an organisation and advise on the 'what', 'where', 'when' and 'how' of assurance needs. As the role of the 'second line' compliance functions grow, on the back of topics such as Data Protection, ESG and risk, ensuring that you have the right balance of assurance across the organisation will be critical.

Internal Audit teams will be thinking carefully about where they can best contribute to managing risk and supporting the success of their organisations. This document sets out some of the key areas that Internal Audit should be considering when thinking about that wider assurance landscape.

# CLIMATE CHANGE



The wide ranging negative impacts of the current climate change projections highlighted in the Intergovernmental Panel on Climate Change report in 2021 are alarming, and have provoked governments, investors and customers to change their expectations of business.



Following on from the COP26 Summit in Glasgow in 2021, there is a renewed governmental focus on reducing greenhouse gases. The implementation of the Task Force on Climate-related Financial Disclosures (TCFD) will make it mandatory for the UKs listed companies to report on climate related risks and opportunities from April 2022.

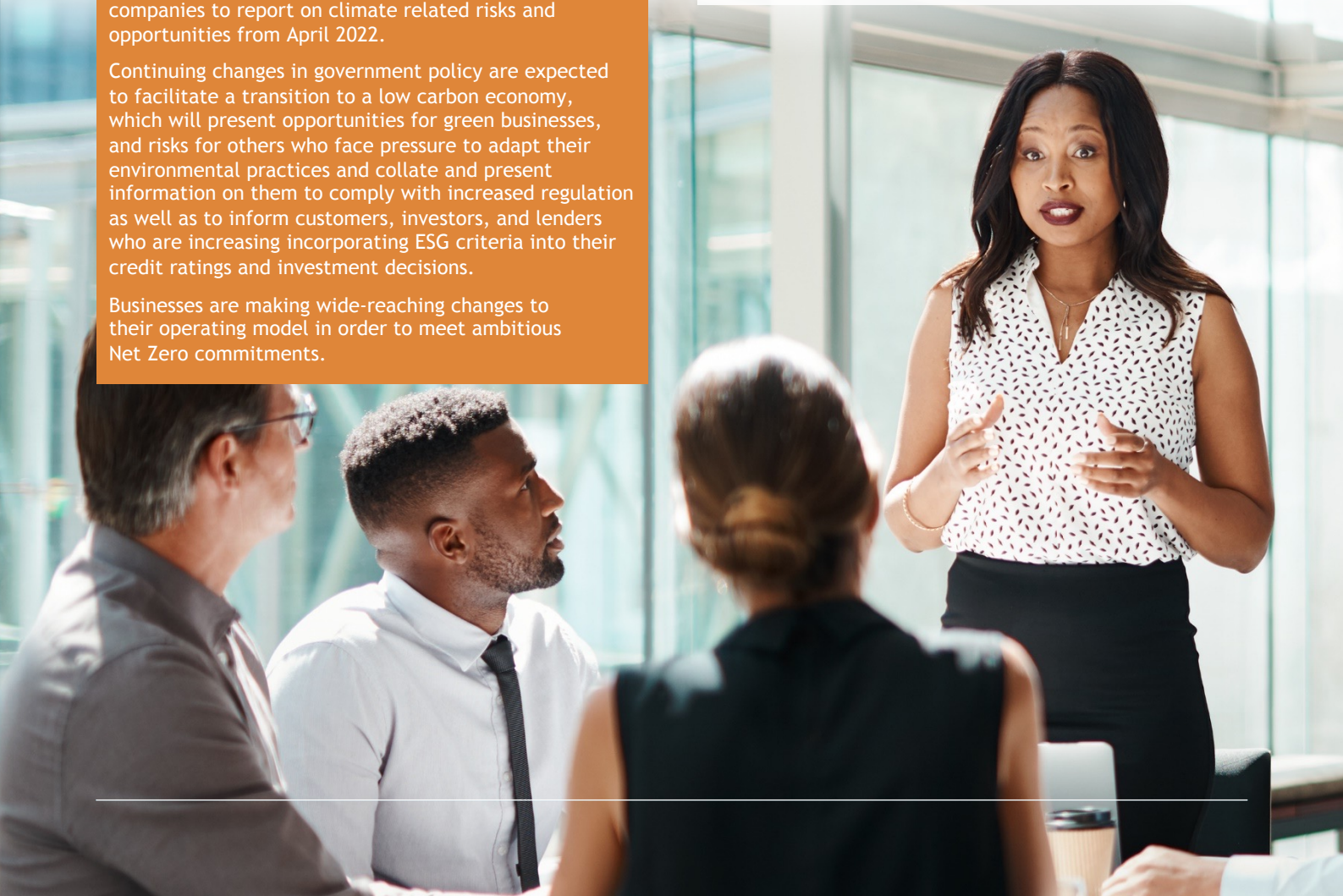
Continuing changes in government policy are expected to facilitate a transition to a low carbon economy, which will present opportunities for green businesses, and risks for others who face pressure to adapt their environmental practices and collate and present information on them to comply with increased regulation as well as to inform customers, investors, and lenders who are increasing incorporating ESG criteria into their credit ratings and investment decisions.

Businesses are making wide-reaching changes to their operating model in order to meet ambitious Net Zero commitments.



## HOW INTERNAL AUDIT CAN SUPPORT

- ▶ Provide valuable assurance around the environmental framework in place to measure and monitor achievement of carbon commitments
- ▶ Provide assurance on the environmental considerations built in to purchasing decisions and key projects, for example, capital builds or transport contracts
- ▶ Proactive assistance to understand and transition to the new reporting regime
- ▶ Facilitation of an assessment of climate risk and opportunity
- ▶ Validate the transparency and completeness of reporting, and the assumptions, calculations, data sets and evidence used in climate change reporting, in response to new regulations.





# GOVERNANCE



The UK Government BEIS consultation, born out of high profile corporate failures and heightened media and public interest has raised expectations around corporate governance and internal controls. The consultation set out wide ranging reforms to the corporate governance regime, including the requirement for a strengthened approach to the internal controls regime over financial reporting. Directors will be required to attest to the effectiveness of the internal controls over financial reporting, a new regime backed by enforcement powers and heightened regulatory responsibilities.



Whilst the exact details of the BEIS requirements are not yet known, there are important actions which businesses must take now to begin to prepare their controls and their compliance and assurance framework for change. Directors are likely to have to make an explicit statement about the effectiveness of internal controls over financial reporting, explain the benchmark system used to make the assessment and explain how assurance is to be provided over the statement. It is not thought likely that external audit assurance over the statement will be mandated.



## HOW INTERNAL AUDIT CAN SUPPORT

Internal audit can support the organisation to:

- ▶ Provide assurance that the impact of BEIS has been evaluated and effective plans are in place to achieve compliance
- ▶ Understand and streamline controls in preparation for compliance, taking the opportunity to strengthen controls and make the control environment more efficient
- ▶ Develop assurance maps in order that directors have a clear view of the assurances available over key controls which they are attesting, and support in developing an Audit and Assurance Policy to set out the assurance framework over financial reporting controls
- ▶ Develop an efficient and effective controls testing programme to increase the quality of the control environment.





# RISK MANAGEMENT



A strong risk management framework supports in:

- ▶ Achievement of objectives
- ▶ Creating and protecting value
- ▶ Assisting organisations with ensuring compliance
- ▶ Enabling informed decision making (i.e. informed risk taking)
- ▶ Improving efficiency of operations
- ▶ Reducing the likelihood of failure.



Organisations are experiencing unprecedented change and require to take agile decisions. A strong risk management framework will help ensure that these decisions are taken in a robust, controlled manner which maximises the likelihood of objectives being achieved.



## HOW INTERNAL AUDIT CAN SUPPORT

Internal audit can support in embedding risk management through providing workshops to raise awareness of the policy and identify and assess risks and can provide assurance that:

- ▶ An effective risk culture has been embedded and everyone understands and plays their part in risk management, with the risk management framework consistently applied
- ▶ Risk management is a part of all operations and systems, integrated with performance management, accountability and decision making structures
- ▶ Risks are identified, analysed and evaluated in line with policy and risk appetite
- ▶ Mitigating actions and reactions are planned and taken in a timely way with clear accountability
- ▶ Risks, relating controls and further actions are reported effectively.





# FINANCE



An effective Finance function will ensure that the business has the right amount of funding and liquidity to meet obligations when they fall due but can also make a valuable and important contribution to wider financial risk management across the business.

Not only is it important to have a clearly defined remit for the Finance function with appropriate delegated authority and risk limits, but the high- value nature of Finance transactions demand a robust and effective control framework that can be delivered on a timely and consistent basis.



## HOW INTERNAL AUDIT CAN SUPPORT

In the context of these changes to the risk landscape internal audit reviews of Finance can add value by considering:

Has Finance policy been subject to review to ensure that the remit of Finance remains appropriate when considering the risks facing the business and is this clearly defined. Given the changing risk landscape, Finance departments are often taking wider responsibilities. For example a business with a material exposure to power prices, may involve their Finance function in hedging the commodity element of power exposures, utilising their access to financial markets (banks and other financial counterparties) and the skills available in the team to manage financial risks.

Does the control environment remain robust, especially where remote working remains in effect, for some or all elements of Finance activity. In recent years the functionality, flexibility and cost effectiveness of Finance systems have all improved. Not only do system-based controls for Finance management deliver a more efficient process for managing Finance transactions, but if implemented correctly can also make a significant difference to the strength of the control framework. The integration between systems is a key consideration here, as well as the need for robust system and user access controls, as well as appropriate continuity, system service and support arrangements.



The risk landscape for Finance is changing:

The Bank of England increased interest rates from historic lows in December 2021. Swap rates have increased sharply, reflecting market expectations for further increases to interest rates which may result in higher borrowing costs.

The exchange rate of the pound against other leading currencies fell significantly after the Brexit vote in 2016 and still remains sharply lower. The risks associated with trade friction and political instability continue to create volatility in the value of the pound.

Power prices rose sharply in the last year, with oil prices increasing considerably with many other examples of volatility in energy and wider commodity markets.

Remote working has necessitated changes to the control environment operated for many Finance functions. These changes are sometimes subtle, and have not been fully considered. This is especially true where manual controls exist and it can be harder to operate or evidence these controls, increasing the risk of fraud or error.



# DATA MANAGEMENT AND DATA QUALITY



In our highly connected world - where our interactions with institutions, public services, organisations, and with one another - data quality and the management of information is critical to success.

Having information that is of a high level of quality (including being accurate, complete, relevant, up to date and secure) is becoming increasingly crucial in the delivery of products and services, in ensuring our ability to communicate and connect, and in building consumer and public trust.



While data management is not a new topic, it continues to increase in importance as organisations move from operating models reliant on analogue processes and traditional customer communications methods to more efficient, effective and innovative ways of working, enabled by digital technology.

Data is now considered a key asset for any organisation, and to deliver value it needs to be of a high level of quality. This supports efficient operations, delivers increased stakeholder value and supports better decision making.

As a result, leaders need to understand the risks relating to data, and ensure that appropriate steps are being taken to achieve a high level of data quality.

Data management can no longer be considered an IT issue. It presents challenges and opportunities all across organisations, and relies as much on organisation culture, robust policies and procedures, controls and performance management as it does on the technology itself.



## HOW INTERNAL AUDIT CAN SUPPORT

- ▶ Assess whether the data culture within the organisation supports effective data management
- ▶ Provide assurance on data management policies, standards, procedures and practices
- ▶ Provide assurance on data quality assurance procedures, and data quality improvement activities
- ▶ Assess the quality of the organisation's data, comparing against standards and good practice
- ▶ Introduce the organisation to good practice master data management principles
- ▶ Facilitate training and development sessions to improve the organisations understanding of good data management.



# CONTRACT MANAGEMENT



The International Association for Commercial and Contract management estimates that poor contract management costs companies the equivalent of 9% of revenue. Getting the right contracts in place (on both the buy and sell side) along with a robust, commercially-focused governance framework to manage these across the lifecycle is an opportunity to optimise outcomes and gain competitive advantage.



## HOW INTERNAL AUDIT CAN SUPPORT

Internal audit can provide valuable assurance that:

- ▶ Procurement and Contract Management functions are operating effectively
- ▶ Suppliers are complying with contracts, fulfilling their obligations and billing accurately
- ▶ Supplier performance is transparent and monitored effectively
- ▶ Contract changes are managed effectively and don't diverge from founding commercial principles
- ▶ Transition to new suppliers is managed effectively.



Reliance on third parties to deliver business critical services is a fundamental reality of today's business world, yet most organisations struggle to realise the value expected from these relationships. In addition, evolving business needs are affecting what businesses require in terms of contract portfolios and agile contract management processes are essential in ensuring the right contractual arrangements are in place to secure an efficient supply chain, and manage change.





# FRAUD



FraudTrack, an annual report compiled by BDO since 2003, tracks reported fraud cases valued at over £50,000 in the UK from December 2019 to November 2020. Each year we analyse the nature of reported fraud from a variety of open news and reporting sources. We have witnessed and studied the rise of fraud from £331 million to over £2 billion in recent years. This year, theft and cash fraud, and other employee fraud increased by 49% and 65%, respectively when comparing 2020 to 2019. Sectors such as Transportation and Warehousing and Public Administration were hit the hardest and there have been noticeable increases in fraud from 2019 to 2020 for the Real Estate sector, experiencing increases of 3,755% and 533% for the Retail Trade sector.



Reported cases are just the tip of the iceberg when it comes to fraud. The Covid-19 pandemic and the associated lockdowns have brought change and challenge to internal control environments. Organisations have been tasked with delivering in new working environments, and this has presented additional fraud risk to identify and manage. Fraudsters are developing increasingly sophisticated tactics at an alarming rate, and the mass digitisation of the workplace has outpaced many firms' ability to secure themselves against exploitation. It is therefore very important, now more than ever, that businesses implement proactive fraud planning and response strategies.



## HOW INTERNAL AUDIT CAN SUPPORT

Internal audit can play an important role in raising awareness of fraud risk and identifying and assessing fraud risks through training and facilitation of workshops. Internal audit can also provide valuable assurance that:

- ▶ There are appropriate and up to date counter-fraud strategies in place
- ▶ Effective fraud risk assessments have been carried out
- ▶ Identified fraud risks have been mitigated effectively, with appropriate controls in place and regularly tested
- ▶ Controls are amended appropriately when new fraud risks emerge.



## PEOPLE



Attracting, retaining and developing the right people, and deploying them effectively, is critical to the success of any organisation. Inclusion and diversity initiatives are also an important part of optimising the people resources, for improved decision making, and also to manage reputational risk in light of requirements to report on gender and ethnicity pay gaps.



Brexit and Covid-19 have impacted on the ability of UK organisations to compete for global resources, and employees have shifting expectations around working life post Covid-19, expecting more flexibility and a better work life balance than before. Many organisations are working on far reaching workforce deployment change programmes.



### HOW INTERNAL AUDIT CAN SUPPORT

Internal audit can provide valuable assurance around workforce planning, recruitment, reward packages, and people development processes, and in particular on changing business requirements and imperatives around how and where resources can be deployed, advising on the decision making around and execution of workforce change programmes.

Internal audit can also provide scrutiny of the planning and achievement of diversity and inclusion objectives and over the data used to report on inclusion and diversity targets.



# SUPPLY CHAIN



A supply chain is about getting the right thing, to the right place, at the right time, in the right quantity and quality for the right price. It covers the spectrum of activities that starts with raw materials and ends with delivery to the end user. Supply chains are becoming more complex as they stretch further across the globe; COVID has highlighted the frailty of the models that rely on predictable outputs and movement. All too often companies were reliant on single suppliers often for critical or scarce products/goods/components or materials. Supply chain disruption is one of life's certainties. An ability to react quickly, stabilise situation and return to a steady state will minimise costs, reputational damage and risk of losing customers to competitors.



## HOW INTERNAL AUDIT CAN SUPPORT

- ▶ Assess maturity of SC Management and SC Resilience
- ▶ Advise on managing supply chain risks, supplier risk and association continuity management
- ▶ Advise on suitability of the SC operating model
- ▶ Advise on component functions of SC Management including procurement, supplier management, contract management, inventory management, logistics planning and management
- ▶ Advise on creating a more resilient supply chain
- ▶ Assess risk management of risks created by suppliers.



The impact of COVID is still being felt, directly and indirectly. Full and partial shut downs of manufacturing facilities, logistic nodes and ports affected ability to both satisfy customer needs and plan with suppliers. The closure of ports, backlogs of ships waiting to berth meant that containers were not being unloaded in time to return to ports of origin. The driver shortages across the world, rising fuel prices, decarbonisation are adding costs to the supply chain to the point that some suppliers are opting to cease trading. The expectations of customers are not reducing, with the desire to know where consignments are at all times being the standard. Digitalisation of the supply chain is becoming increasingly important to support customer service, to manage the complexity and support business functions such as finance and business continuity.

UK companies have not been immune to the impact of COVID; arguably the impact has been exacerbated by the transition from the EU. The construction sector, for example, was affected as demand for raw materials including steel, timber, PVC and chemicals exceeded supply.



# CYBER RISK



Cyber security remains a corporate priority. Businesses depend more and more on digital technology to operate efficiently and deliver for their customers and clients. Cyber criminals are continuously evolving their methods and their use of technology.

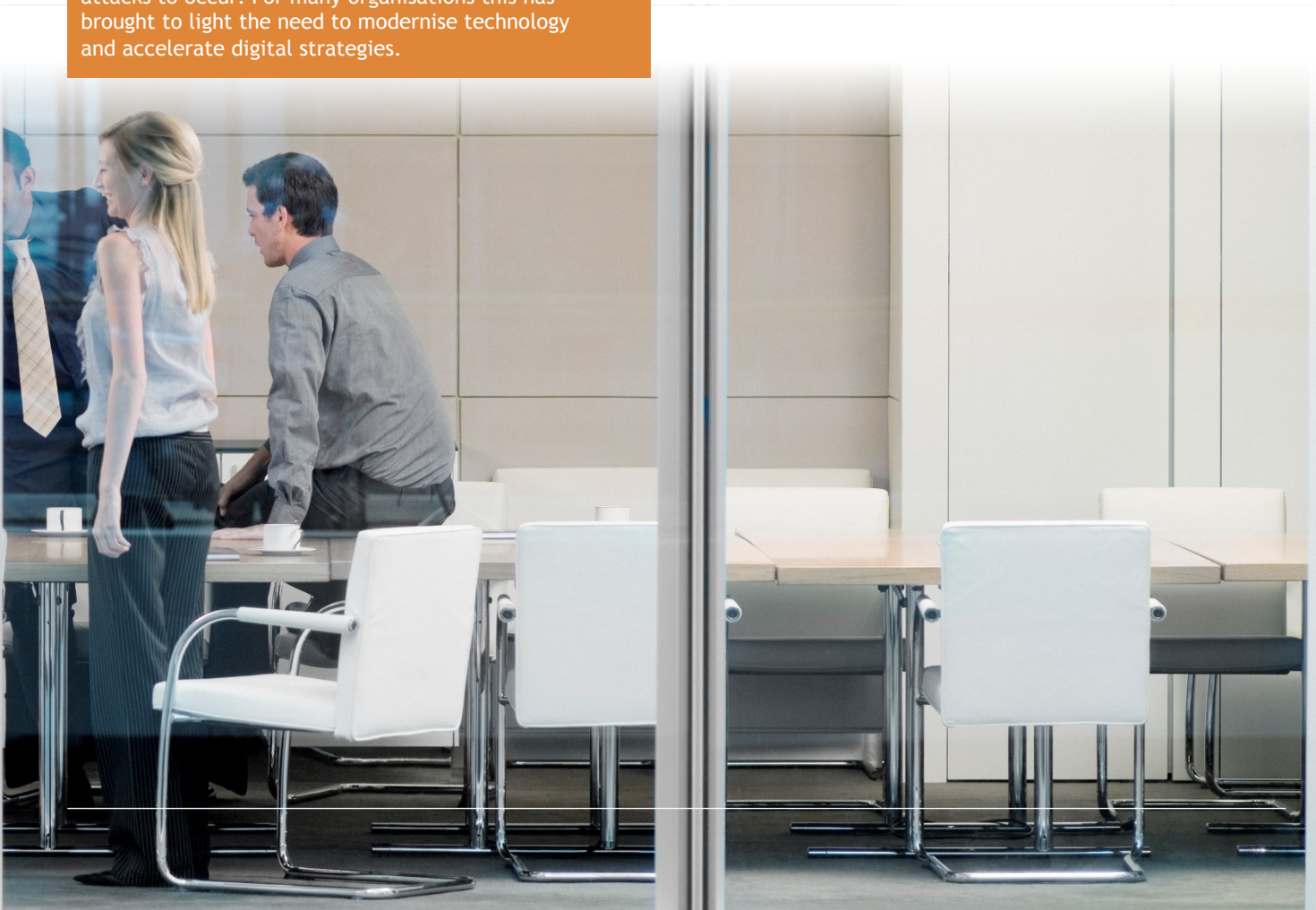


Over the last 12-18 months cyber attacks have risen to record levels, as reported by the National Cyber Security Centre (NCSC) in their Annual Report 2021. One of the most notable cyber security issues stems from Covid-19 and the impact remote working has had. The mass shift from office-based work to working from home has changed and increased the opportunity for cyber attacks to occur. For many organisations this has brought to light the need to modernise technology and accelerate digital strategies.



## HOW INTERNAL AUDIT CAN SUPPORT

- ▶ Identify and assess weaknesses in cyber security and find any issues around compliance with the latest regulations
- ▶ Utilise 'best in class' cyber technologies to remediate identified issues and improve cyber resilience
- ▶ Advise on appropriate protection levels around critical assets
- ▶ Design appropriate cyber responses and strategies
- ▶ Provide robust, size-appropriate managed services built on proven technologies.





## TECHNOLOGY RISK & GOVERNANCE / CLOUD



Organisations are under pressure to implement technology that drives efficiencies and supports new ways of working. Technological change must be implemented securely and be supported with appropriate governance, testing and training arrangements to ensure the value is realised and risks are mitigated.



The global pandemic accelerated the pace of digital transformations for many organisations. The move to remote working has brought about significant change to how technology is used. For many, this has meant increasing reliance on third parties to manage technology in the cloud, which can reduce control and increase risk.



### HOW INTERNAL AUDIT CAN SUPPORT

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# PROGRAMME MANAGEMENT



An organisation should always have a clear understanding of the purpose of the project. The objectives and scope should be specifically aligned to one or more corporate objectives and supported by a detailed, proportionate business case giving clarity of the costs and benefits. By having these foundations in place will help give confidence that the project is valid and that progress against the business case can be proactively tracked. Ultimately an organisation's approach to both return on investment and benefits realisation need to be integrated with business planning activities as this will help ensure a robust management focus beyond the specific programme or project. Without this focus then projects will struggle to communicate their value and ultimately how they are being successful.



## HOW INTERNAL AUDIT CAN SUPPORT

- ▶ Provide support and advice on the end-to-end project management delivery process from 'Idea to benefits realised'
- ▶ Provide assurance on the identification and development of projects from business case development to approval
- ▶ Developing/Reviewing benefit management framework, processes, and procedures, based on industry good practice and to delivery business value
- ▶ Training and development workshops to improve the organisations understanding on Benefit Management and how this can be effectively implemented.



The pressure to deliver successful change is ever increasing, and organisations are faced with significant economic and commercial challenges as well as increased regulation and legislation, when trying to deliver their portfolio of projects. Return on Investment and business benefit delivery are fundamental to making the 'right' investment decisions and justifying the inclusion and progression of every project.





# CULTURE



Corporate culture refers to the beliefs and behaviours that determine how a company's employees and management interact and handle outside business transactions. Often, corporate culture is implied, not expressly defined, and develops organically over time from the cumulative traits of the people the company hires.

Understanding the true culture of an organisation can get to the heart of what helps or hinders an organisation, and can help detect early warning signs of broader organisational issues.



There are increased expectations around corporate culture, with movements like Black Lives Matter, #MeToo and broader equality issues, ethics and values receiving heightened media and business attention.



## HOW INTERNAL AUDIT CAN SUPPORT

- ▶ Internal audit can compare espoused with actual behaviours to assess whether organisations are living their values, and provide assurance over how organisations maintaining ethical and cultural values in the post-pandemic world. They can also conduct root cause analysis of silo based mentality and negative behaviour and identify compliance issues stemming from ethical lapses (not arising from process or operational bugs)
- ▶ A full audit typically involves an assessment of whether the organisational values are fully in evidence in business decisions and operations and incorporated in key processes including governance, communication, recruitment, induction, training, performance management and reward structures
- ▶ A partial audit may also be considered. This aims to provide assurance on specific matters relating to the culture of the organisation, and can also be used to investigate whether there are underlying cultural reasons for recurring issues. Where a process is failing repeatedly, we can conduct root cause analysis to help identify specific reasons for issues occurring and whether there are cultural drivers for unsuitable behaviours.





# ORGANISATIONAL RESILIENCE



## WHY IT'S IMPORTANT?

Resilience is the business' ability to change or adapt during times of stress, disruption, or uncertainty. It integrates the concepts of risk, crisis management, business continuity planning and organisational leadership and learning to provide a platform for developing more robust and agile organisations.

It is vital that organisations have the ability to prevent, adapt and respond to, recover and learn from operational disruption.



## HOW INTERNAL AUDIT CAN SUPPORT

Internal audit can provide assurance on where the organisation is on its implementation of resilience and whether plans and strategy for implementation look to deliver expected outcomes, and the extent to which broader requirements such as incident response, third party management etc. are incorporated. It can also provide assurance over whether we have adequate due diligence over third party resilience.

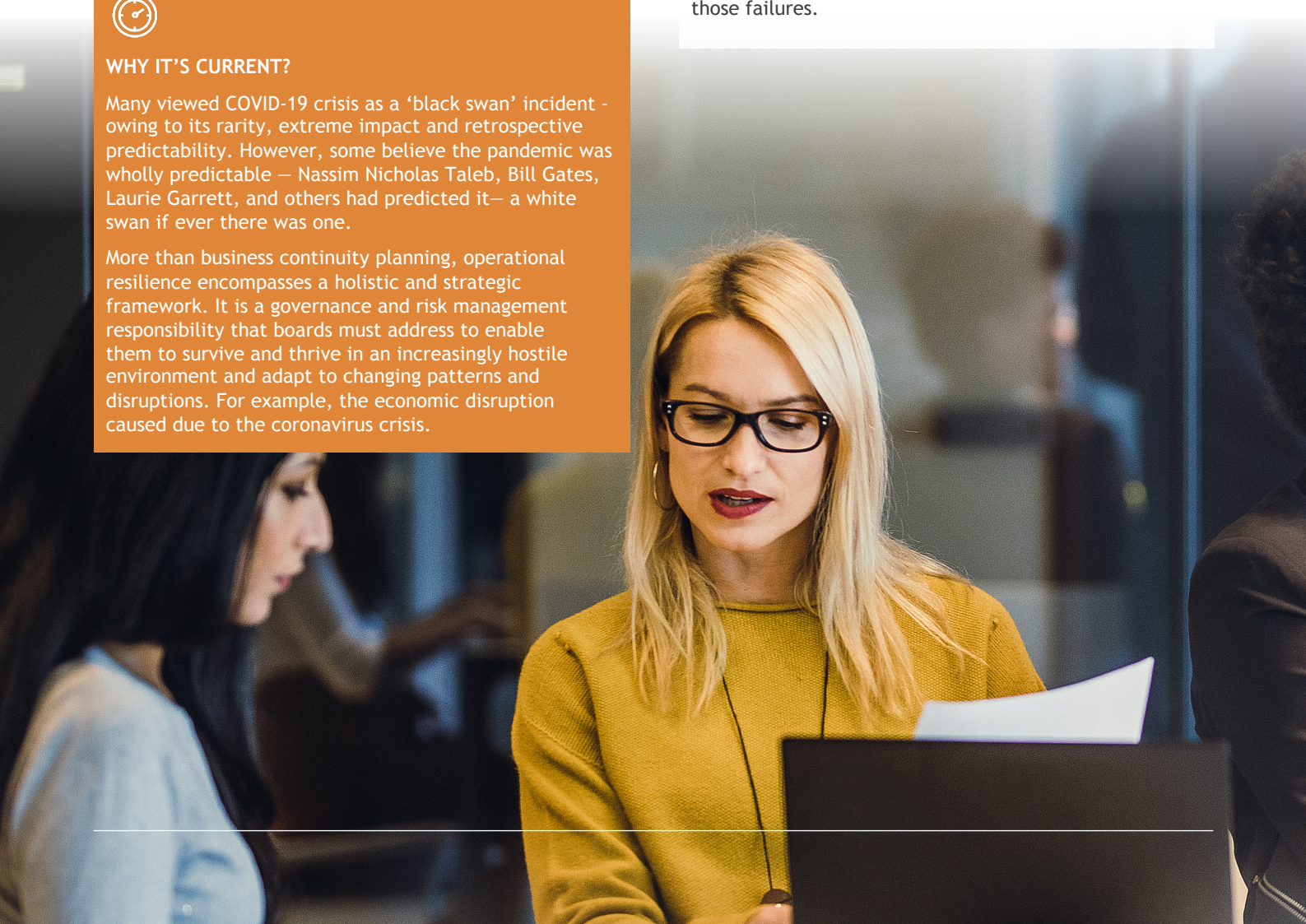
Internal audit can use multiple data sources to analyse transaction volumes, customer base composition etc. and define impact tolerances and then using simulation, desk-top exercise or both, determine the organisations ability to remain within those tolerances, and where failures are identified in the scenario testing, assist with the design of a mitigation strategy for remediating those failures.



## WHY IT'S CURRENT?

Many viewed COVID-19 crisis as a 'black swan' incident - owing to its rarity, extreme impact and retrospective predictability. However, some believe the pandemic was wholly predictable – Nassim Nicholas Taleb, Bill Gates, Laurie Garrett, and others had predicted it – a white swan if ever there was one.

More than business continuity planning, operational resilience encompasses a holistic and strategic framework. It is a governance and risk management responsibility that boards must address to enable them to survive and thrive in an increasingly hostile environment and adapt to changing patterns and disruptions. For example, the economic disruption caused due to the coronavirus crisis.





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