

Managing the Internal Audit Function

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**THE ANNUAL INTERNAL AUDIT CONFERENCE
ICPAK**

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Agenda

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- ✓ Meaning of Internal Auditing
- ✓ Brief on IPPF Performance Standards
- ✓ IA management challenges
- ✓ Overcoming the challenges
- ✓ Internal audit framework

Meaning of Internal Auditing

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- It is 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.

Internal Audit Function

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- Internal audit function is expected to maximize the assurance provided to the Board, the Audit Committee and Management, and contribute to the continuous improvement strategies of the organization without impairing its objectivity and independence.
- Internal auditor's role involves providing guidance and expertise in areas including, but not limited to, corporate governance, ERM, fraud policies and prevention, and information technology systems, in addition to the traditional area of internal controls.

Managing the Internal Activity – IPPF Standards

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- **2000-Managing the Internal Audit Activity**
 - ❖ The CAE must effectively manage the internal audit activity to ensure it adds value to the organization.
 - ❖ The IAF is effectively managed when:
 - ✓ The results of the IA's work achieve the purpose and responsibility included in the internal audit charter;
 - ✓ The IA conforms with the definition of internal auditing and the standards; and
 - ✓ The individuals who are part of the IAF demonstrate conformance with the Code of Ethics and the Standards.

IPPF-Performance Standard cont....

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- **2010-Planning**

- The CAE must establish risk based plans to determine the priorities of the internal audit activity, consistent with organization's goals.

- **2020-Communication**

- The CAE must communicate the internal audit activity's plans and resource requirements, including significant interim changes, to senior management and the board for review and approval.
- The CAE must also communicate the impact of resource limitations.

Standards cont.....

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- **2050 –Coordination**

- The CAE should share information and coordinate activities with other internal and external providers of assurance and consulting services to ensure proper coverage and minimize duplication of efforts.

- **2060-Reporting to senior management and the board**

- The CAE must report periodically to senior management and the board on the internal audit activity's purpose, authority, responsibility, performance relative to its plan.

Performance Standards cont....

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- **2030-Resource Management**

- The CAE must ensure that internal audit resources are appropriate, sufficient and effectively deployed to achieve the approved plan.

- **2040-Policies and Procedures**

- The CAE must establish policies and procedures to guide the internal audit activity

Challenges in Managing the IA function

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“When people talk, listen completely. Most people never listen.” Ernest Hemingway

IA management challenges

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- The current business environment has turned the spotlight on the role that a robust internal audit system must play within the larger drive towards effective governance, risk, compliance and quality management.
- An internal auditor has to work as a savvy in-house cop who not only reports problems, but also gives constructive suggestions to line managers about how to improve the performance of the business.

Challenges continued

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- The challenges include:
 - ✓ Immature implementation of risk strategies;
 - ✓ To-down view;
 - ✓ Complex financial disclosures;
 - ✓ Complex business models;
 - ✓ Growing regulatory guidelines & compliance;
 - ✓ Risk quantification;
 - ✓ Governance;
 - ✓ Toe-at-the-top
 - ✓ Monitoring and oversight;
 - ✓ Information sharing and communication;

Challenges explained

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Immature implementation of risk strategies

- *Audit committees says reports presented by management not meaningful/useful-AC survey report.*
- *Key challenges include identifying risks early-on, and maintaining a 'big picture' view of the risks facing the business.*
- *AC focus on risk management processes, quality of risk inventories & assessment, and quality of risk management reports.*

Top-Down-View

- *Fraud resulting from weak top management and control environment puts auditors on spotlight to view the business from the top-down, and increase scope of reviews at corporate offices.*
- *The purview should not only include day to day transactions, but specific monthly, quarterly, and yearly management processes that strongly influence the financial statements.*

Challenges explained

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Complex financial disclosures

- *Board shoulders the ultimate responsibility for the integrity of the corporation's financial disclosure.*
- *Challenge for internal auditors is to identify if there are discrepancies in company's financial statements, confirm whether they are abiding by the financial reporting standards, verify whether sufficient controls are in place, and affirm whether shareholders or potential investors or lenders have sufficient information to make informed decisions.*
- *The Management is responsible for a fair presentation of the financial statements but the internal audits department must ensure that the financial statements do pass the litmus test.*

Complex business models

- *The board and management are responsible for ensuring the integrity of the business,*
- *The internal auditor is responsible for validating, directly or indirectly, whether the company's business model is sound. Internal audits confront issues like: "Will the company be able to survive, or compete in the market?" "Does it adhere to sound business practices?" "Does it have appropriate place for risk management and corporate governance programs in organization?"*
- *This increases the potential for negative circumstances like inconsistency in enforcing audit processes across business units, erroneous data collection, and various gaps that result from isolated silos of information.*

Challenges explained

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Growing regulatory guidelines & compliance demands

- *Stipulations and guidelines are regularly reviewed and refined to retain their effectiveness.*

Risk quantification

- *Risk is an integral part of any endeavor.*
- *The risk management unit and the risk management committee are responsible for risk management, but it is the internal auditor's task to ensure the risk management program works.*
- *An effective internal audit management system depends on the ability to build process cycles against an accurate matrix of assessed risk.*
- *However, given the dynamic regulatory environment and the complex inter-connectedness of business functionalities, it is often extremely difficult to assess the multi-faceted nature of business risk.*

Challenges explained cont...

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Information sharing & Communication

- *Organizations assist each other by sharing experiences and lessons. It would also be advantageous for boards and executive management to drive the implementation of such a model throughout the business.*
- *This should provide those who lag behind with a better perspective on risks and controls and what areas need to be considered in the everyday conduct of business to allow employees to take a proactive approach in enhancing the control environment.*

Monitoring & Oversight

- *Most organizations expect internal audits department to provide additional input to management, the board of directors, and the audit committee in form of monitoring and oversight; ensuring compliance monitoring and enforcement of essential requirements.*
- *To address the issue of weaknesses in oversight programs, the department needs to establish the minimum standards for monitoring compliance and risk management programs.*
- *These standards should address compliance monitoring activities; technical assistance; enforcement; and documentation, analysis, and reporting of results.*
- *Stiff penalties for non-compliance have prompted employers and employees to take a proactive approach to reduce the risks of fraud within their organizations.*
- *With an increase in awareness and interest in corporate governance, the audit function faces rise in the number of special requests.*
- *Increase in demand for services, implementing a system to evaluate and prioritize the nature and timing of reviews will provide an additional challenge for businesses and their audit function.*

Challenges explained

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Governance

- *An ideal corporate governance framework consists of seven entwined elements: the board and its committees, legal and regulatory concerns, business practices and ethics, disclosure and transparency, ERM, monitoring, and communication.*
- *It is the task of internal auditors to review each of these elements, and report their findings on a scorecard, rating their maturity along a scale as "compliant", "developed", or "advanced."*
- *At the outset, the CAEs need to review key organizational documents such as articles of incorporation, board and committee minutes, the annual report, investor relations policy, code of conduct and ethics, shareholder rights, and board calendar of events.*

Tone-at-the-top

- *Top-to-down 'buy in' for internal audit is something that can only be achieved when the leadership of the company is sensitized to and convinced of the vital impacts it has on compliance, quality, business continuity, and operational profitability.*
- *Internal auditors should work closely with the audit committee to establish the audit department's responsibilities, and the board and management should support those duties.*
- *However, internal audit processes can sometimes be ignored by the top management, who may choose to focus time and resources on areas they deem to be more pressing to bottom lines.*

Overcoming the challenges

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- To address the rising expectations of chief stakeholders, internal audit needs to find new ways to deploy its risk and control-based skills to help the organization achieve its strategic objectives and enable value creation. That effort extends to activities such as:

Overcoming challenges

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BoDs & Sr. Management oversight

• Internal Auditor's assessment of the role of the top management in overseeing a company's efforts should address objective considerations, such as whether the necessary resources (people and otherwise) and tools have been dedicated to the compliance and risk management effort, whether the tone-at-the-top is inclined towards having tighter internal controls, and whether the board of directors and senior management, through their words and actions, are communicating the importance of risk awareness across the company.



Risk identification & assessment

• The audit should examine whether the risk assessment process synchronizes with latest changes in the organization, addresses all activities conducted by the company, includes all applicable regulatory requirements, and documents the methodology used to conduct the risk assessment.



Role accountability & responsibility

• Consider the credibility, qualifications, and experience of key personnel who have been assigned the critical tasks.
• Internal auditors are charged with the responsibility of assuring the board of directors that management, financial systems, and processes are working effectively.
• It is important for the internal auditors to have direct reporting channels to the board.

Overcoming challenges

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Policies & Procedures

- Internal Auditor's assessment should focus on the company's process for ensuring that policies and procedures are comprehensive, reviewed and updated on a periodic and reasonably frequent basis as well as accessible and understandable.



Internal Controls

- Consideration of whether or not there is a system of adequate internal controls should be second nature to any internal auditor. The considerations are much the same as they would be in any other auditable area: separation of duties, access limitations, second review processes and proper documentation of review and approval,
- (Manual & Automated)



Self-monitoring & Remediation

- Internal auditor's evaluation of a company's self-monitoring and remediation activities should begin with verifying that the monitoring program incorporates requirements specifically mandated by laws or regulations, and that it is appropriately aligned with Compliance's risk assessment.

Overcoming challenges explained

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Reporting & Record
keeping

IA should also review how the company manages the myriad of reporting and record keeping requirements faced by financial services companies.

Internal Audits Framework

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- *Ever growing complex regulations have had significant implications on Internal Audits function – changing the environment within which the rules for security, reliability, and permissible margin of inaccuracy were formed.*
- *Internal auditors, today, need to adopt an integrated auditing approach while evaluating the internal controls, processes and procedures of an organization.*
- *The COSO while defining internal control, in its report titled “Internal Control- Integrated Framework”, emphasized on the role of internal audits to help management monitor the control system and make them aware of its strengths and weaknesses.*

Areas to focus on internal audit framework

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Structure & resources

- *Before embarking upon the auditing process, internal auditors establish the structure of the internal audit function and assess the key internal audit personnel to perform audit, and their respective roles and responsibilities. Where the function is outsourced, the focus includes the terms of the outsourced arrangement and how this is monitored.*

Independence

- *The board should ensure that the independence of the internal audit function is maintained. The internal auditor should maintain dual reporting relationship to management and the organization's most senior oversight group. The internal auditor should report to executive management for assistance in establishing support, and administrative interface; and typically to the audit committee for strategic direction, reinforcement, and accountability.*

Approach

- *The approach taken by internal audit should be clear and may be one, or a combination of risk-based focus on the high-risk areas of the institution; and review-based focus on reviews of various parts of the institution. The board should endorse the approach and it should be scalable to future change, such that it adapts agilely to issues requiring internal audit involvement.*

Framework cont....

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Segregation of duties

- *Segregation of Duties ensures that no one person is solely responsible for the entire process end-to-end, without effective checks and balances. For example, key authorization processes should have appropriate checks and balances. The person, who documents the transaction, should not be the same person who conducts the transaction. These simple checks and balances ensure effective controls and reduce organizational error rates.*

Policies and procedures

- *Written policies and procedures codify management's criteria for executing an organization's operations. They document business processes, personnel responsibilities, departmental operations, and promote uniformity in executing and recording transactions. Thorough policies and procedures serve as effective training tools for employees.*

Internal Audit Plan

- *The internal audit plan, which usually details the proposed internal audit work for the next 12 months, should be documented and endorsed by the board. Importantly, the plan should be consistent with the type of approach to be taken and should be adequate for the scale and complexity of the institution's operations.*

Frameworks cont....

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Audit Data

- *The internal audit should capture audit-related data on a single database for the entire enterprise, so that all data mining, benchmarking, and trend analysis processes are significantly improved.*

Reviews & Approvals

- *When a process is performed within a department, there should always be another level of review and approval performed by a knowledgeable individual independent of the process. The approval should be documented to verify that a review was done. Review and approval are controls that help management gauge whether operational and personnel goals and objectives are being met. In this time and age of emails and web technologies, it is easier to document your approvals if you can refrain from verbal approvals and use electronic methods to approve key policies and processes.*

Reporting

- *Internal auditor should report findings to the Audit Committee (or board) regularly. Serious issues should be elevated to senior management and the Audit Committee (or board) without delay. The reporting infrastructure is not just a way to create visibility into the status of key processes and activities, it also enables the management and the auditors a way to get possibly real-time visibility into the key indicators of your organization. Reporting of key Corrective Actions and Preventive Actions, Process KPI's, employee training status to key processes, supplier and partner scorecards, quality maintenance reports on critical equipments and plants is a simple example of a well-designed management reporting system.*

Q & A

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“Individuals play the game, but teams beats the odds.” SEAL Team Saying