Emerging trends in internal audit and risk governance

Facilitators: Ruth Cruz, Ernst & Young LLP
Brian Taylor, Ernst & Young LLP
Disclaimer

► EY refers to the global organization, and may refer to one or more of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young LLP is a client-serving member firm of Ernst & Young Global Limited operating in the U.S.

► This presentation is © 2015 Ernst & Young LLP. All rights reserved. No part of this document may be reproduced, transmitted or otherwise distributed in any form or by any means, electronic or mechanical, including by photocopying, facsimile transmission, recording, rekeying, or using any information storage and retrieval system, without written permission from Ernst & Young LLP. Any reproduction, transmission or distribution of this form or any of the material herein is prohibited and is in violation of U.S. and international law. Ernst & Young LLP expressly disclaims any liability in connection with use of this presentation or its contents by any third party.

► Views expressed in this presentation are those of the speakers and do not necessarily represent the views of Ernst & Young LLP.

► This presentation is provided solely for the purpose of enhancing knowledge on tax matters. It does not provide tax advice to any taxpayer because it does not take into account any specific taxpayer’s facts and circumstances.

► These slides are for educational purposes only and are not intended, and should not be relied upon, as accounting advice.
Topics for discussion

- Risk landscape and Internal Audit’s (IA) evolving role
- Emerging risks
- Internal audit framework and trends
- Internal audit analytics
- Question and answer
Risk landscape and IA’s evolving role
Rapid changes in business world creates a changing and volatile risk landscape

These forces challenge the way organizations think about, manage and respond to risk.
As stakeholders demand more, the internal audit mandate evolves

► While compliance activities are still key (e.g., SOX, FCPA, etc.), the business is demanding more value-add activities through business insights and strategic advice.
Perspectives on internal audit trends
IA is evolving with increasing business complexity and challenges

Internal Audit will continue to be expected to fulfill compliance mandates while also providing business insights and acting as strategic advisor to the business, all while maintaining or reducing costs.

Chief audit executives are faced with challenges to meet the evolving demands with their traditional audit organization and approaches.

Audit Committee and management expectations

Strategic and value advisor

Business insights

Control environment and compliance

Business issues, risks, initiatives and key objectives

Chief audit executives are faced with challenges to meet the evolving demands with their traditional audit organization and approaches.

Today 27% of IA functions are considered strategic advisors, but in 2 years 54% want to be advisors**

The biggest skill gap for these companies’ IA staff is data analytics**

60% of companies look to reduce audit fatigue to help business focus on achieving business objectives

80% surveyed believe doing more with less is the way forward for internal audit

Source – Ernst &Young 2012 Global IA Survey with Global Audit Committee Members, Chief Audit Executives (CAEs), CEOs, COOs and CFOs of Global 1000

**Source – Ernst &Young 2013 Global IA Survey with Global Audit Committee Members and CAEs of Global 1000
Audit committee (AC) considerations for internal audit

Questions we are hearing the AC ask their CAEs

- How are Internal Audit activities aligned with the strategic objectives of the business?
- How would you describe the overall financial health of the organization?
- How can IA help us understand overall health of internal control environment in organization?
- What questions should we be asking other executives?
- What is the implication of identified issues? What does it mean to the business?
- What are the current areas of exposure? What should we be worried about?
- What strategic initiatives or process improvements have been identified through Internal Audit?
- What strategic initiatives or process improvements have been identified through Internal Audit?
- Does IA have enough of the skills to effectively execute against it’s mandate?

Questions we are hearing the CAEs ask their ACs

- What are Audit Committee’s expectations of the IA mandate?
- Does the current IA mandate align with the overall company strategy?
- Will I get the resource and budgetary support to elevate the IA function?
- How do you recommend IA execute its mandate beyond the assurance projects?
- What is the preferred cadence for communication?

Considerations for IA’s focus

- Alignment between CAE and Audit Committee – priorities and focus must be complementary, not competing – driving towards overall common goal
- No “one size fits all” – each company needs to find their right balance between culture, priorities and key imperatives
- Continued focus on providing baseline assurance while driving efficiencies and adding value to the business

<table>
<thead>
<tr>
<th>Considerations</th>
<th>Risk</th>
<th>Financial</th>
<th>Compliance</th>
<th>Operational</th>
<th>Strategic</th>
</tr>
</thead>
<tbody>
<tr>
<td>Approach</td>
<td></td>
<td>Assurance</td>
<td></td>
<td></td>
<td>Advisory</td>
</tr>
<tr>
<td>Skills</td>
<td></td>
<td>Technical/execution</td>
<td>Innovation/collaboration</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Considerations</td>
<td></td>
<td>Increase efficiency via new test methods</td>
<td>Provide value – more subject matter resource (SMR) and higher level resources required</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Key considerations for internal audit – are we balancing risk, cost and value?

Are we focused on the risks that matter?
Are we duplicative or overlapping with other risk functions?
Do we have effective risk reporting for executive management and the Board?
Do we have a comprehensive IA risk framework in place?
Do we truly understand the risks that our company is taking?
Are we incorporating the above questions into our audits?

Are we focused on the risks that matter?
Are we duplicative or overlapping with other risk functions?
Do we have effective risk reporting for executive management and the Board?
Do we have a comprehensive IA risk framework in place?
Do we truly understand the risks that our company is taking?
Are we incorporating the above questions into our audits?

Are we focused on the risks that matter?
Are we duplicative or overlapping with other risk functions?
Do we have effective risk reporting for executive management and the Board?
Do we have a comprehensive IA risk framework in place?
Do we truly understand the risks that our company is taking?
Are we incorporating the above questions into our audits?

In the next two years, 54% of survey participants* expect that their primary role will be to serve as strategic advisors to the organization

*source EY/Forbes Insights IA Survey 2013, survey participants are CAEs

---

<table>
<thead>
<tr>
<th>IA Organizational Design &amp; Planning</th>
<th>Trends</th>
<th>Leading practices</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Move to a more dynamic audit planning process</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Audit Plans developed on a 3+9 basis, with the next three months firmly planned and subsequent nine months indicative</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Business intelligence and continuous monitoring provide information constantly being assessed for audit planning implication</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Coordinate among risk functions</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Align with or leverage work of other risk functions – compliance, ERM, SOX, etc.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Consolidate results into one report for management and board</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Utilize local and/or offshore resources</td>
</tr>
<tr>
<td></td>
<td></td>
<td>For routine processes or audits, utilizing offshore resources will enable the function to control costs</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Utilizing local resources conserves travel expenses, gives added benefit of local knowledge and can identify talent for IA</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Co-sourcing relationship</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Flexible resource model with the ability to ramp up or down depending on Company needs</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Allows you to maintain organizational knowledge while adding leading class IA methods</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Deep subject matter resources available for technical areas</td>
</tr>
</tbody>
</table>
Emerging risks
Several of the challenges facing organizations have remained the same since 2013, indicating respondents to this survey continue to focus on strategic risks.

Top 5 Challenges In 2013*
- Economic stability
- Cyber threats
- Technology shifts
- Strategic Transactions
- Regulatory changes

Top 5 Challenges In 2015
- Economic stability
- Competitor innovation
- Regulatory changes
- Cyber threats
- Reputation

Top 5 Strategic Risk Management Opportunities In 2015
- Benefiting from the upside potential of strategic risks
- Effectively evaluating and responding to a changing risk landscape
- Anticipating and predicting new and emerging risks
- Establishing ownership, structure and processes to better manage risk
- Leveraging risk insights to improve decision-making

*Responses obtained in the 2013 EY Internal Audit survey
2015 EY GRC Survey insights –
Current challenges (1 highest – 5 lowest priority)

Source: EY 2015 GRC Survey
Emerging risk areas

Only 27% of respondents say they are heavily involved in identifying, assessing and monitoring emerging risks.

*Source EY/Forbes Insights IA Survey 2013*
Internal audit framework
Ernst & Young LLP internal audit framework – summary level

**Core delivery methodology**
- Establish engagement protocols
- Conduct audit needs assessment
- Develop audit plan
- Execute
- Communicate results

**People model**
- Develop resource & deployment strategy
- Define competency plans & training
- Share knowledge

**Support processes**
- Emphasize quality assurance & continuous improvement
- Employ project management principles
- Use professional practices
- Enable through technology
- Track & monitor key performance indicators

**IA strategy**
- Assess stakeholder needs
- Coordinate across risk functions, maintain objectivity
- Define mandate & vision

**Independence and objectivity**

**Measurable impact**
- Enhance control environment
- Drive business insights
- Enable strategic initiatives

**Leverage organizational strategy**

**Develop well-aligned IA strategy**

**Employ critical enablers throughout**

**Run IA operations like a business**

Leverage enterprise intelligence (analytics, continuous monitoring)
Some common focus areas that we are seeing make a difference at multiple organizations supported by Ernst & Young LLP’s IA framework:

- **IA strategy**
  - Align with business on IA’s strategy, vision and mandate
  - Coordinate with other risk/oversight functions for optimal coverage

- **Core delivery methodology**
  - Reevaluate risk assessment and audit plan refresh processes
  - Re-engineer audit responses to risk
  - Incorporate thematic audits and end-to-end process audits into audit plan
  - Determine the appropriate mix of assurance and advisory effort
  - Perform issue-based audits, leveraging subject matter resources
  - Refresh IA reporting to board, management and auditees

- **People model**
  - Align IA organizational structure to business structure and risk profile for optimal coverage
  - Revamp talent management processes (e.g., competency and rotation models, training, resourcing)

- **Support processes**
  - Track key performance indicators on a value scorecard to demonstrate value to key stakeholders
  - Increase efficiency of audit process and transparency of data through a strong technology platform
  - Consider IA branding and revitalize stakeholder engagement

- **Enterprise intelligence**
  - Employ innovative techniques (e.g., behavior analysis, data analytics, continuous monitoring) to drive efficiency and results

**This framework drives toward the increased measurable impact IA has on the organization**
Current trends that are driving changes to how internal audit creates value

<table>
<thead>
<tr>
<th>IA Execution</th>
<th>Trends</th>
<th>Leading practices</th>
</tr>
</thead>
</table>
|              | High impact audits | ▸ Include high impact audits in the plan  
▸ Address technical and/or complex areas that require specialized skills to audit  
▸ Perform projects around hot topic risk areas (conflict minerals, cyber security, emerging markets, etc.) |
|              | Using data analytics throughout audit cycle | ▸ Developing data analytics programs that provide greater coverage  
▸ Utilize and implement predictive modeling and/or continuous monitoring to drive efficiency  
▸ Identify trends that may be missed using traditional sampling techniques |
|              | Implement a dynamic risk assessment | ▸ Refresh risk assessment periodically (quarterly or triggering events)  
▸ Triggering events may include: significant transactions, team management changes, new products, litigation, etc. |
|              | Focus on emerging risks | ▸ Establish a process for identifying emerging risks  
▸ Collaborate with key stakeholders  
▸ Assess impact and velocity of risks |
|              | Enhanced IA communication | ▸ IA reporting to include benchmarking against sector peers and root cause analysis  
▸ Periodic and informal updates to the Audit Committee and C-suite about emerging risks and management’s response |
Internal Audit functions require the appropriate skills and experience to address the risks associated with a rapidly changing landscape. Participants in the GRC survey identified these as:

1. Critical/analytical thinking
2. Analytics
3. Risk management
4. Audit
5. Business strategy

Organizations must appropriately develop and align talent with the requisite skillsets across each of their lines of defense.
# Internal audit resourcing alternatives

<table>
<thead>
<tr>
<th>In-house model</th>
<th>Co-source model</th>
<th>Outsourced model</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Definition</strong></td>
<td>A third-party provider is engaged to work under the direction of the company’s IA leader to provide assistance and support as needed across all aspects of the IA function.</td>
<td>A third-party provider is engaged to operate all aspects of the IA function under the supervision of the company’s designated Internal Audit leader.</td>
</tr>
<tr>
<td><strong>Characteristics</strong></td>
<td><strong>Staffing</strong></td>
<td><strong>Staffing</strong></td>
</tr>
<tr>
<td></td>
<td>► All aspects of recruiting, training, performance management and career management</td>
<td>► Internal staff supplemented by outside resources to meet defined resource needs (quantity, locations, skill sets)</td>
</tr>
<tr>
<td></td>
<td>► In house methodology must be developed</td>
<td>► Company may at its option develop an internal methodology and technology platform or may leverage the co-source provider’s methodology and technology investments</td>
</tr>
<tr>
<td></td>
<td>► Audit software must be developed or purchased, implemented and maintained</td>
<td>Knowledge resources</td>
</tr>
<tr>
<td></td>
<td>► Access to publicly available content, informal networks or professional organizations</td>
<td>► Co-source provider brings knowledge of other companies, benchmarks and leading practices</td>
</tr>
<tr>
<td><strong>Applicability</strong></td>
<td>► This model is generally driven by corporate culture considerations or a priority placed on using IA primarily as a source of talent to the business</td>
<td>► Instant elevation of internal audit function while allowing time for transition needed to build out a fully functioning department</td>
</tr>
<tr>
<td></td>
<td>► Internal audit is viewed as a core competency of the organization</td>
<td>► Provides on-the-job training to in-house staff</td>
</tr>
<tr>
<td></td>
<td></td>
<td>► Flexible model; IA as a variable cost</td>
</tr>
</tbody>
</table>
Internal audit analytics
2015 EY GRC Survey insights – Internal audit analytics

Where does IA use data analytics in the audit lifecycle?

<table>
<thead>
<tr>
<th>Process/Compliance Area</th>
<th>Today</th>
<th>In 3 years</th>
</tr>
</thead>
<tbody>
<tr>
<td>Risk assessment</td>
<td>37%</td>
<td>4%</td>
</tr>
<tr>
<td>Planning</td>
<td>46%</td>
<td>11%</td>
</tr>
<tr>
<td>Execution and testing</td>
<td>72%</td>
<td>49%</td>
</tr>
<tr>
<td>Reporting</td>
<td>26%</td>
<td>52%</td>
</tr>
<tr>
<td>IA effectiveness/performance</td>
<td>20%</td>
<td>42%</td>
</tr>
<tr>
<td>I don’t know</td>
<td>7%</td>
<td>30%</td>
</tr>
<tr>
<td>Not at all</td>
<td>10%</td>
<td>38%</td>
</tr>
</tbody>
</table>

In which processes or compliance areas does IA use data analytics?

- SOX testing: Today 18%, In 3 years 24%
- Fraud review: Today 15%, In 3 years 25%
- Anti-money laundering: Today 25%, In 3 years 25%
- General ledger and reporting: Today 38%, In 3 years 55%
- Fixed assets: Today 31%, In 3 years 50%
- Investments: Today 20%, In 3 years 30%
- Procure to pay: Today 39%, In 3 years 54%
- Order to cash: Today 36%, In 3 years 57%
- Inventory: Today 36%, In 3 years 42%
- Travel and expenses: Today 72%, In 3 years 48%
- HR and compensation: Today 7%, In 3 years 35%
- I don’t know: Today 7%, In 3 years 11%
- Not at all: Today 10%, In 3 years 10%
Internal audit analytics maturity model

Developing and aligning an analytics program will be critical in efficiently completing your IA plan, while providing more business insight and value to your organization.

### Common challenges
- Lack of robust implementation strategy
- Skill gaps – tools, data, process knowledge
- People – training, competency development
- Enablers – technology platforms

### 1 – Initial
- No formal analytics approach, procedures or methodology
- Performed occasionally at best
- Tools are not readily available
- Dependent on skills of limited number of SMRs

### 2 – Repeatable
- Recognized as a value-add to the audit
- Not yet institutionalized
- Relies on a central group or single person
- Tools are at a disposal, however, not applied consistently or correctly

### 3 – Defined
- Enforced analytics policy
- Established analytics methodology
- Use of analytics championed by IA management
- Quality of analytics results are evaluated
- Understanding of the business meaning of analytics procedures and results

### 4 – Managed
- Methodology is institutionalized
- Management involved in the ongoing analytics efforts
- Management understanding of business issues and root cause
- Re-performance of analytics procedures
- Advanced tools are used

### 5 – Optimized
- Practices evolved in level 1 through 4 are used to continually improve analytics processes, procedures and results
- Continuous control monitoring tools

---

**Highly effective, efficient and insightful**

**Improved efficiency and business insights**

**Basic control and compliance**
# Four steps to start an analytics program

## Develop strategy

1. **Vision/strategy and quick win identification**
   - Vision/strategy/quick win
   - Current state analysis
   - Strategy design workshop
   - Risk analytics strategy
   - Analytics scoping framework/heat map alignment
   - Detailed road map
   - Business case
   - Quick wins
   - Scoping workshop
   - Analytics profile/integrated audit program
   - Data requirements/mapping
   - Data acquisition/standardization
   - Analytics results/reporting

## Design and build

2. **Enablement**
   - Program enablement
   - Deployment work plan
   - Resourcing models
   - Training program
   - Technology strategy
   - Integrated methodologies/procedures
   - Knowledge management

3. **Integration**
   - Analytics delivery/audit integration
   - Risk-based planning
   - Data acquisition/standardization
   - Analytics/behavioral analysis
   - Integrated audit results/reporting
   - Program metrics dashboard
   - Analytics profiles
   - Integrated audit programs
   - Data requirements/mappings

## Run and operate

4. **Measure and sustain**
   - Program optimization
   - Cross-functional resource models
   - Advanced analytics training
   - Integrated business intelligence (BI) technology strategy
   - Centralized analytics libraries/logic

   **Enterprise risk integration**
   - Risk modeling
   - Audit optimization strategy
   - Continuous auditing

   **Business integration**
   - BI integration
   - Continuous monitoring
   - Performance modeling
## Typical challenges and key considerations

<table>
<thead>
<tr>
<th>Framework</th>
<th>Typical challenges</th>
<th>Key considerations</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Define</strong></td>
<td>► Complex organizational processes and structures exist within the business, which is a challenge to scoping and design of data analysis.</td>
<td>A focus on the following key points will deliver an initial immediate uplift, while ensuring that in the long term, the full benefits of using analytics will be realized and sustained.</td>
</tr>
<tr>
<td></td>
<td>► Knowledge of the business processes is not readily available within the organization.</td>
<td>► Complete a technical sizing exercise, understand the limits of the technology and select the right tool for the right outcome</td>
</tr>
<tr>
<td><strong>Produce</strong></td>
<td>► There is difficulty in accessing data from the ERP systems (mixture of legacy and customized ERP systems).</td>
<td>► Consider change and journey management</td>
</tr>
<tr>
<td></td>
<td>► Data extraction can be time-consuming.</td>
<td>► Define a data life cycle and manage data effectively</td>
</tr>
<tr>
<td></td>
<td>► Poor data quality can occur when data is extracted from the system, or uncertainty over data integrity may exist.</td>
<td>► Deliver training on how to interpret and take action on the results of the analytics</td>
</tr>
<tr>
<td><strong>Consume</strong></td>
<td>► Auditors struggle to convert the data to insight (lack skills to interpret analytics results).</td>
<td>► Build momentum and deliver early success</td>
</tr>
<tr>
<td></td>
<td>► Auditors are unclear on what activities they can stop doing.</td>
<td>► Build in continuous feedback, driving refinement of analytics and education for users</td>
</tr>
<tr>
<td></td>
<td>► Control risk assurance and analytics looking over periods (trend analysis) will represent new activities (and require new skills) for auditors.</td>
<td>► Focus on what auditors should <strong>stop</strong> doing</td>
</tr>
<tr>
<td><strong>Governance and</strong></td>
<td>► Internal auditors may have the technical skills but lack industry, business process, issue or other experience.</td>
<td>► Deliver audits that are <strong>better, faster, different</strong></td>
</tr>
<tr>
<td>strategy</td>
<td>► Return on investment can be unclear.</td>
<td></td>
</tr>
</tbody>
</table>
Questions and answer
Thank you!

Brian Taylor  
Senior Manager  
brian.taylor2@ey.com  
+1 312 879 5429

Ruth Cruz  
Senior Manager  
ruth.cruz@ey.com  
+1 703 747 1002