Audit 2020: The Evolution of Internal Auditing over the Next 10 Years

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Agenda

- Who am I?
- What is Audit 2020?
- A Little History
- Where is IA heading?

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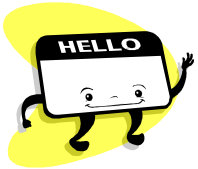
I. Introduction



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- Founding Partner, SOFT GRC (www.thesoftaudit.com)
- Former Director of Corporate Audit/SOX at Dr Pepper Snapple Group & Tyler Technologies
- Texas A&M University – 97/98
- Served on the Audit Committee of the Dallas Independent School District
- Published Author
  - *Internal Auditor* Articles (April 2007, December 2007, October 2010)
  - *ISACA Online* Article – December 2009
  - June 2010 – *Audit Report* – Cover Article – "How the Recession is Changing is Internal Audit"
  - December 2010 *New Perspectives - Sell Your Work:* How to Deliver Best Practice Audit Reports
  - November 2010 – *Bureau of National Affairs* - Internal Audit: Fundamental Principles and Best Practices
  - January 2011 – *Dallas Business Journal* – The Yes Man Phenomenon

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What is Audit 2020?

What Lies Ahead in the Future?

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Clarity

A Little History

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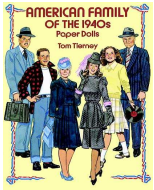
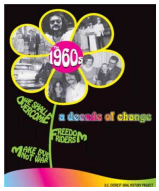
The Roller Coaster Since 2000

Prior to the 1970's

- In the earliest days, internal auditors frequently functioned as assistants helping an organization's external auditors.
- Formation of the IIA in 1941
  - Internal auditors practiced using "traditional" methods through 1960.
  - Quality control activity for the controllership function.
  - Traditional internal auditing was designed to be the "eyes and ears" of the controller to check whether the widespread accounting operations of rather large organizations were performed properly in accordance with corporate policies.
  - Many internal audit activities considered issues involving compliance and the economy, efficiency, and effectiveness of operations.





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Circa After the Early 1970's

- Modern internal auditing began to be practiced more generally in the 1970s.
- Sawyer's Internal Auditing
- Modern internal auditing takes a broader view.
- Contemplated a more expansive range of services including "operational auditing" and services to a wider spectrum of management at both senior and lower levels.
- Thought leaders began to view consulting, including methods for improving the efficiency and effectiveness objectives of internal control, as an important mission of internal auditing.
- 1978 – First IIA Standards Issued
- Changed in two other important respects.
  - Internal auditors took responsibility for analyzing an increasing variety of an organization's operating functions. These operating functions included office procedures, purchasing, manufacturing, logistics, research and development and other staff functions.
  - Internal auditors took increasing interest in reviewing compliance with laws, regulations, policies and procedures.

Late 1970's/Early 1980's

- Internal auditing began to function as an independent appraisal function to all levels of the organization.
- During the 1980s, the focus on controls began to shift away from controls themselves toward an emphasis on the risks demonstrating a necessity for such controls, their functioning, and the risks that could prevent an organization from reaching its objectives.

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1990's (Modern IA)

- Evolution of internal auditing from a control to a risk orientation in the governance processes
  - Parallels the change toward flatter organizations that emphasize innovation and team achievement
  - Mirrors the expanded internal auditing involvement with increasingly strategic aspects of business operations and their inherent risks
  - Internal auditors are no longer merely concerned with administrative processes

The early 2000's

- Financial Boom
- Major Corporate Integrity Issues
- Sarbanes-Oxley
  - Year 1
  - Year 2
  - Auditing Standard No. 5

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The late 2000's

- Recession
  - RIF's
  - Outsourcing
- Too Much Focus on Just Compliance (with SOX)
  - Lack of Balance
  - "We do this Just for SOX"
- The New Economic Norm

RIFs - Ramifications of Actions

- Economic downturn = Increased risk
- People Cuts = Control Cuts = Increased Risk
- Cost cutting becomes a main priority ➡ Certain risks areas might lack focus necessary during normal economic times.

"It is not time to decrease controls; its time to strengthen the control environment"

2010 Results

- A peak to trough economic contraction of 6% has seemingly resulted in a 1% loss in the number of people working in internal auditing
- Very little evidence that in response to the recession companies have resorted to general cuts in the numbers of internal auditors they employ
- Recession has actually increased the demands on many internal audit departments as they have become involved in risk and cost reduction programs
  - Due to the increasingly specialist nature of internal audit work, many companies lack the ability to recruit internally

SOURCE: Barclays Simpson – Winter 2010

Internal Audit – Circa 2011

- Internal auditing is widely recognized as an important part of an organization's governance structure
- Still rooted in SOX
  - AS 5 Rationalization is not complete
  - Lack of leveraging knowledge into other areas
- Risk focused
  - Significant segregation between Operations and IT
  - Still working in silo's

What is the New Economic Norm?

- It will be years before we are back to the levels of prosperity of 10-15 years ago
  - Job market
  - Conservative hiring practices
  - Many bankruptcies
  - Tumultuous times in the Middle East and around the world
  - Showing signs of a recovery but recoveries are all relative

Where is IA Heading?

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Audit 2020: Where we are Heading?

- Transparency
- Continuous Risk Assessment
- Audit Team Compilation
- IFRS
- Continuous Auditing/Monitoring
- The Resurrection of Operational Auditing
- The Rise of Audit Flex Time
- The Rise of the CRO/CCO

Transparency

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Transparency

- The key modern word for Internal Auditing
- Many audit shops embrace this theory
- Transparency breeds trust ➡
- Trust breeds honesty ➡
- Honesty breeds efficient and effective audits
- We have nothing to hide

Transparency (cont.)

- Surprise audits might be necessary but if not….
- Publish the audit schedule
- Publish the audit risk assessment
- Walk auditees through the preliminary risk assessment
- Enlighten auditees as soon as findings are identified
  - No surprises!

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What is an Audit Risk Assessment?

- Identification and analysis of relevant risks to the achievement of an organization's objectives, for the purpose of determining how those risks should be managed.
- Initial determination of operating objectives, then a systematic identification of those things that could prevent each objective from being attained. In other words, it's an analysis of what could go wrong.
- Not all risks are equal.
- Some are more likely than others to occur, and some will have a greater impact than others if they occur.
  - **probability** and **significance** must be assessed.
- The risk assessment process is an **ongoing** one.

Audit Risk Assessment - Overview

1. Define the audit universe and identify the auditable units within the entity for which these analyses will be carried out.
2. Identify appropriate risk factors designed to reflect management's concerns.
3. Evaluating risk factors (e.g. heat map) so that the more important risk factors play a more prominent role in the risk assessment process than less important risk factors.
4. Develop a combination rule for each audit unit which will properly reflect its riskiness over several risk factors that have been identified and a method of setting audit priorities for the audit units.
5. Once audit units have been rated according to their riskiness, it is important to have a mechanism for assigning them to audit frequency categories and a mechanism for applying variable audit scope or intensity of auditing commensurate with the importance of the audit unit.

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Continuous Risk Assessment

- Audit Risk Assessment should be refreshed **annually** and **<u>reviewed periodically</u>**
- Changing economic times = changing risks
- Audit Risk should be constantly monitored and assessed with increased scrutiny
- Auditing methodology should evolve directly alongside changing economics
- Considering the instability of the market and of business, risk should be assessed continuously or as risk factors change or information arises

Continuous Audit Risk Assessment

6. Assign an Audit Resource to be charged with the task of monitoring the risk assessment and audit schedule.
7. Based on Steps 1-5, update risk assessment as the information comes to light or circumstances change.
8. ARA should be updated based on the same standards and factors that were utilized initially.
9. Audit schedule should have built-in flex time (20-30%) in order to alter the schedule as circumstances change
   - Under commit, over perform
10. Update Management and the Audit Committee at least quarterly or as major changes come into play.

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The Rise of Audit Flex Time

- Flexibility of Audit Schedule
  - 25-30% of schedule
- Ever changing spectrum of risks
- Allocation to fraud investigations
- General idea of key risks to audit annually
- Traditional audit approach - more reactive than proactive
  - Adopt a continuous, comprehensive approach to audit and risk assessment - use technology (continuous auditing)

Audit Team Compilation

Multi-Purpose Auditors

- The days of CPA's/CIA's and CISA's are past
- One audit team will perform the audit
- General auditors will have to have some semblance of IT knowledge and ability
- Silo's will continue to dissipate
- CFE qualities and capabilities will also integrate

Specialty Auditors

- Focus on technical auditing, including forensics and IT
  - CISSP
  - IT Security
  - Penetration Testing

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Pulled into IFRS

- Becoming the global standard for the preparation of public company financial statements
  - Convergence is occurring now!
- Who better to help apply these new standards
  - More difficult than SOX
  - Changing the way accountants think; not formalizing what is already in place

What is the difference between convergence and adoption?

- Adoption would mean that the SEC sets a specific timetable when publicly listed companies would be required to use IFRS as issued by the IASB.
- Convergence means that the U.S. Financial Accounting Standards Board (FASB) and the IASB would continue working together to develop high quality, compatible accounting standards over time.
  - More convergence will make adoption easier and less costly and may even make adoption of IFRS unnecessary.
  - Supporters of adoption, however, believe that convergence alone will never eliminate all of the differences between the two sets of standards.

SOURCE: www.ifrs.com

IFRS – IA's Role

- As with SOX, IA provides a specialty that can assist the company with new projects. Numerous roles could be played, including:
  - Training
  - System implementation
  - Strategy implementation
  - Project management specialist

Continuous Auditing/Monitoring

Continuous Auditing/Monitoring

- Changing technology in Business
  - Think about it: How much have things changed since you were in college?
- Real-time Auditing
- Changing Auditing technology landscape
  - Continuous auditing/monitoring
  - Data mining
- Data mining/Risk Analysis and Risk Assessment predicted as highest gainers in skill set importance
- How to really apply continuous auditing?
- Watch out for becoming the control

The Resurrection of Operational Auditing

- The New Economic Norm
- How do we become more than SGA?
  - Can we be viewed as Revenue Enhancers?
- Leverage current knowledge and expertise
  - Change the perception of SOX
  - Change the name of SOX?
- Look for the low hanging fruit
- Lean Six Sigma
- Focus on Cost/Benefit

The Resurrection of Operational Auditing

- Be relevant, not redundant
- Stay in front of the business rather than lagging behind it
- Be involved in company changes and system implementations without impairing independence
- Independence is a significant gray area
- Be a part of the project team

SOX Optimized

- Auditing Standard No. 5 Maximized
- More preventative vs. detective controls
- Focus on Entity-level controls
  - Direct
  - Indirect
- Alignment with external auditors
- Capturing changes in the dynamic business environment
- Part of project implementation teams
- Controls Rationalization

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The Rise of the CCO/CRO

- Executive accountable for enabling the efficient and effective governance of significant risks, and related opportunities, to a business and its various segments
  - Commonly In-House Counsel
- Cross-training and leveraging of compliance and risk groups throughout organization
  - ERM
  - SOX
  - Audit
  - Fraud
  - FCPA
- One unified, integrated approach to compliance and risk

Summary

- Auditors must continue to be value added resources
- We must continue to evolve with our organizations
- The New Economic Norm will continue to play into the role of internal audit
- Always look for ways to add value

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