

Post-Pandemic: Five Questions Organizations Should Ask About Internal Audit

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Introduction

As a result of the COVID-19 pandemic, businesses are operating in a new and uncertain economic environment. This publication addresses the increasing number and complexity of risks facing organizations in this uncertain environment and focuses on how internal audit can adapt its role to “build value” while helping to mitigate these risks. It does so by identifying the five most important questions organizations should consider to effectively oversee internal audit.

1. Should our organization have an internal audit function?

Organizations around the world are struggling to minimize business disruption from COVID-19 while navigating new realities. They are also recognizing the complexity that increasing governance expectations, emerging risk and new regulation can add to their accountability. Internal audit can play a critical role in helping an organization discharge its governance responsibilities as it emerges from the current crisis.

As the COVID-19 pandemic continues to disrupt the economy and the day-to-day lives of Canadians, governments of all levels and their agencies have provided financial relief and taken other remedial actions. Businesses that have benefited from government subsidies or support will likely face increasing regulatory oversight and be subject to greater public scrutiny. In addition, they will continue to be held accountable for meeting high compliance standards to protect themselves and markets more broadly.

Internal auditors can assist by allowing those responsible for running the organization to discharge their roles and responsibilities more effectively and by providing them with a level of objective assurance on the quality of internal controls. An internal audit function can help an organization manage its risks, processes, and controls that impact key strategic goals and objectives – thus mitigating scrutiny by regulators – and, if desired, it can help management to provide its assurance over fraud and financial reporting controls.

The size and maturity of the organization are important factors to consider; internal audit is not a requirement for all organizations. Smaller organizations may believe that they receive sufficient comfort through the oversight currently in place, for example, through self-monitoring, direct owner or management supervision, information system security, and health and safety checks. Therefore, they may already have an acceptable level of assurance inherent in their existing risk management arrangement and not require a designated internal audit function. Nevertheless, organizations should seriously consider the value that independent assurance and advisory services provide in helping them discharge their governance responsibilities.

As organizations generally adapt to new realities, larger and more complex businesses may face additional risks that require a heightened level of oversight, monitoring and expertise. For instance, consider an organization entering into new markets or developing new lines of business or products to ensure continuity in a market disrupted by the pandemic; internal audit can help the organization prepare for the increased risk landscape and provide its management with insights as the associated processes and controls are developed.

2. What new capabilities are leading internal audit functions developing today?

Emerging risk and best practice internal control trends should dictate the new capabilities in which internal audit should invest, such as data analytic expertise and cyber security knowledge.

Though all organizations anticipate an eventual return to business as usual (or a modified version of the pre-pandemic universe), exactly when this will occur, and what the transition back will look like, are largely unknown. What makes internal audit unique is its strength and experience in managing uncertainty. Uncovering and tackling risk is what internal audit teams are trained to do.

It is critical that such teams develop and continually update their skill sets to keep pace with the challenges facing their organizations in the current climate, including new risks arising from cyber and reputational threats. Assembling the right skills depends on two elements: the risk profile of the organization and the audit strategy or plan that has been developed to provide the requisite assurance over the controls in place to mitigate risks to an acceptable level. In all cases, the assembled skills must be aligned with those needed to successfully execute the audit plan.

The leading internal audit functions recruit staff with a variety of backgrounds and professional experience, to match the operations and risk areas of the company (for example, engineers, actuaries, information technology and healthcare). Before approving the audit plan, those responsible for oversight should also ask whether the assembled skill set is sufficient to successfully execute the audit plan.

In addition to addressing the current impact of the pandemic, organizations should consider addressing the transition to the post-pandemic future. New capability such as data analytics is becoming increasingly popular with internal audit functions for specific audit testing, continuous monitoring and auditing. It is also being used for predictive analysis. As technology and software become more sophisticated and user friendly, the use of data analytics will continue to grow, especially as remote working becomes the norm. Internal audit functions either have an in-house data analytics expert, or they outsource this capability to a third party.

Organizations should also be seeking greater capability within internal audit to support IT governance and cyber security. Some of the key related risks are cyberattacks that can disrupt already compromised business operations or result in a breach of privacy or confidential data. Every organization should continually ask what capabilities will be required to address such emerging risks.

3. How does internal audit anticipate and adapt to emerging or changing risks?

On a continuous basis, internal audit should be engaging senior management and other internal and external stakeholders about the latest initiatives, projects, external trends and best practices.

Organizations navigate a wide range of external and internal drivers of risk. Currently, the single largest source of risk for most organizations is the disruption caused by unanticipated developments relating to COVID-19. Other risks, more typically, include the following:

- data loss caused by a cyberattack
- material financial misstatement caused by changes in leadership
- penalties and reputation risk related to new regulatory requirements
- revenue loss due to competitive entities, products and services
- credit rating decline driven by economic conditions
- legal and regulatory issues caused by hostile mergers and acquisitions
- cost overruns caused by change such as implementing a new ERP (enterprise resource planning) system
- financial loss related to major capital projects
- extraordinary expenses linked to changing climates and environmental events
- demand loss due to shifting social and cultural attitudes
- market share erosion due to technological changes and competitive innovations
- incremental expense related to changes in government leadership or policies
- margin erosion tied to shifts in the price of commodities, oil and gas, and other inputs

While COVID-19-related developments are ongoing, the focus for most organizations is on returning, to the greatest extent possible, to business as usual. As organizations adapt to the “new normal,” those responsible for oversight should be satisfied that internal audit is anticipating – and has considered the impact of – the various risks to its organizational objectives, resources and audit plan.

On a continuous basis, internal audit should be proactively engaging senior management and other internal and external stakeholders about the latest initiatives, projects and external developments. Where appropriate, boards can also play a role in informing internal audit of any anticipated significant changes on the planning horizon.

4. How should management be held accountable to address or resolve audit findings?

Management will always be the first line of defence to prevent, detect or react to risk, and therefore they should also be expected to expedite control improvements recommended by internal audit.

Many businesses are struggling to cope with the challenges imposed by COVID-19, in part because of the limited attention given to business continuity in the past. The internal audit function is often in the best position to provide new insights to management, advising on the impact of such challenges to the organization’s risk and opportunity landscape and improving structured reflections on the measures taken and anticipated.

Internal audit should be responsible for adapting current programs so that they monitor and report on the status of management action plans resulting from audit findings. This can be done through periodic checkpoints and by conducting follow-up audits. This gives internal audit an opportunity to examine remedial actions in detail and gather evidence to support management's conclusion that action plans have been carried out and completed sufficiently. The results of these follow-up actions should be reported to those responsible for oversight.

Where appropriate, boards should determine whether management is engaged in developing and completing action plans to mitigate the risks associated with internal audit findings. They should also receive status updates on open action plans at each meeting, and hear about significant past-due action plans with corresponding executive sponsors, deadlines and reasons for the delay.

When management has not adhered to the response timelines, boards may choose to invite the executive sponsor to provide an update and revised plan. Taking an active role to hold management accountable will reinforce the board's commitment to corrective action and send a message to senior management that resolving audit findings is important.

There are certain instances where management may decide not to take any corrective actions associated with an audit finding. If this is the case, internal audit should document that senior management understands and accepts the risk, and then highlight this to the board.

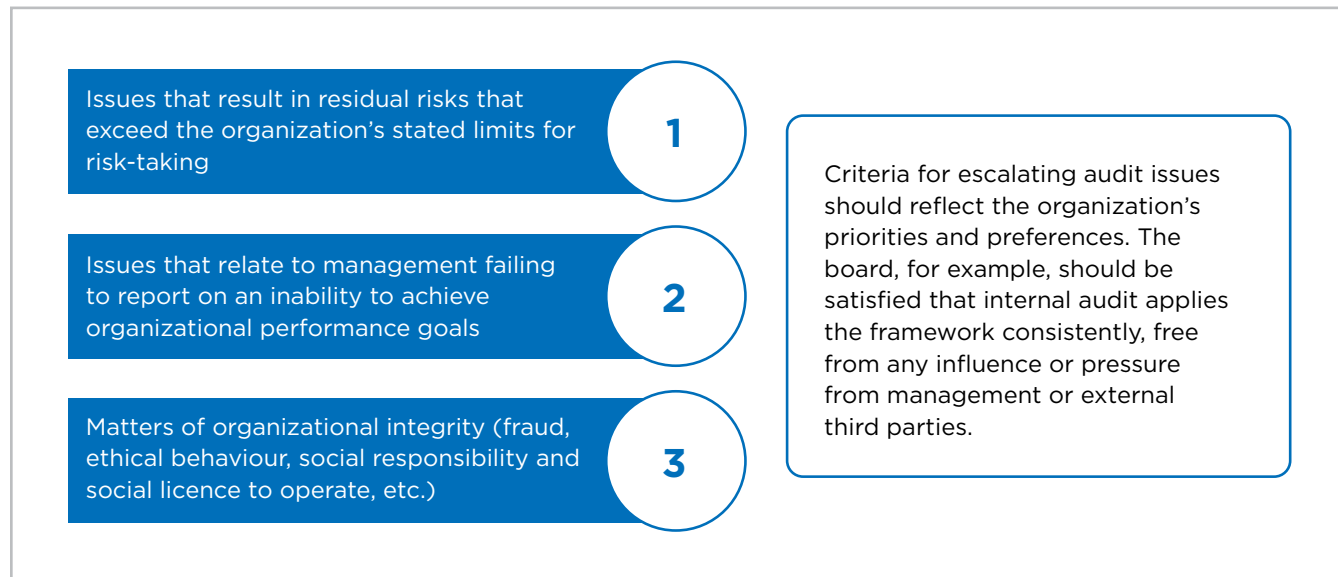
5. How does internal audit determine what risk and control issues should be reported?

Judgment is required to determine whether a risk exposure or control issue is significant enough to warrant attention, and this is why establishing criteria is critical.

When faced with COVID-19, internal audit may understandably feel that it is in uncharted territory. Businesses are dealing with an avalanche of new risk and control issues – which demand rapid responses in an environment that changes by the hour.

In these challenging times, the internal audit function has both an obligation and an opportunity to help organizations manage the most critical risks that COVID-19 has either created or magnified. While business leaders juggle the dual imperative of crisis response and operational continuity, internal audit can inform their decisions by helping them weigh risks and opportunities.

Criteria can be established to provide guidance on what the internal audit function should report to management and, where appropriate, to the board. As a starting point, the criteria should comply with relevant standards, which state that significant audit findings, such as risk exposures and control issues including fraud risks, should be reported. However, judgment is required to determine whether a risk exposure or control issue is significant enough to warrant it being highlighted at the board level, and this is why establishing criteria is a critical activity. The following are three categories of findings or developments that typically warrant reporting:

FIGURE 1: THE THREE CATEGORIES OF FINDINGS OR DEVELOPMENTS THAT TYPICALLY WARRANT REPORTING

Conclusion

Many internal audit functions have increased their profile within their organization by evolving their capabilities to deliver greater strategic value (with the definition of “value” being established by key stakeholders including the board, audit committee, executive line management and other risk focused functions within the organization).

In the current environment, internal audit should focus on:

- delivering objective assurance as well as providing valuable recommendations that help the organization to achieve strategic objectives while effectively and efficiently addressing relevant risks
- remaining strategic, agile, informed, collaborative and capable

At some point, a new business-as-usual environment will emerge. If internal audit is engaged to provide critical guidance *now*, while also preparing for that future, it will emerge as a stronger team, providing even greater value to the department and to the business.