Evolution and the Future of Internal Audit

Presentation by:

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Sola currently handles financial Risk Management and has rolled out risk management framework for financial services organisation as well as developed a corporate governance framework for financial institutions in sub-Saharan Africa, which has been implemented enterprise-wide by most firms. He has worked with various institutions including KPMG (Audit & Risk Advisory), BGL Plc, Kedari Capital Limited, Sahara Energy Resource Limited & Sovereign Trust Insurance Plc (Finance & Investment).

He is a member of the Institute of Chartered Accountants of Nigeria (ICAN), Chartered Institute of Taxation of Nigeria (CITN) and the acclaimed Institute of Internal Auditors (USA).
# Table of Content

<table>
<thead>
<tr>
<th>I</th>
<th>Definition and Components of Internal Audit</th>
</tr>
</thead>
<tbody>
<tr>
<td>II</td>
<td>Setting the Scene - Macro Market Trends</td>
</tr>
<tr>
<td>III</td>
<td>The Shifting Role of Internal Audit from Providing Information to Interpreting Information – Value Creation</td>
</tr>
<tr>
<td>IV</td>
<td>Integrated Assurance</td>
</tr>
<tr>
<td>V</td>
<td>Innovation, Technology, and Tools - Continuous Auditing</td>
</tr>
<tr>
<td>VI</td>
<td>Talent Management</td>
</tr>
<tr>
<td>VII</td>
<td>Single View of Risk</td>
</tr>
<tr>
<td>VIII</td>
<td>Internal Audit of the Future</td>
</tr>
</tbody>
</table>
Definition and Components of Internal Audit

Internal audit helps an organization to accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of

✓ Risk Management,
✓ Internal Control,
✓ Governance processes.

Internal Audit is an independent, objective assurance and consulting activity designed to add value and improve an organization’s operations.
Risk Management is a process which satisfies appropriate transition or exchange between risk and yield and adds “value” to the organization.

**Identification of Risks**
- Defining the risks
- Measuring the risks
- Analysis the risks
- Reporting

**Prioritization of Risk**
- Probability of the Risk
- Severity of the Risk

**Taking Necessary Actions**
- Acceptance
- Transferring
- Controlling

Risk management concerns all departments.
Definition and Components of Internal Audit (Cont’d)

Internal Control

Control is one of the actions which are taken to mitigate the effects of the risks in terms of:

- Safeguarding of assets,
- Compliance with laws, regulations, and agreements,
- Reliability and integrity of financial and operational information,
- Effectiveness and efficiency of operations.

Basic Control Activity Examples are:

- Authorization Methods
- Limit Applications
- Decompositions of Tasks
- Policy and Procedures
- Task Descriptions and Responsibilities
- Reconcilement Methods
**Corporate governance** is a general system which promotes enterprise orientation and control structure.

As generally accepted international corporate governance understanding involves:

- **Equality**
- **Transparency**
- **Accountability**
- **Liability**
II Setting the Scene – Macro Market Trends
Setting the Scene - Macro Market Trends

- Capital markets
- New risk types
- Single view of risk
- Innovation
- Credit downturn
- Energy markets
- New regulation & compliance burden
- Competition
- Cost optimization
Factors Driving Change

External factors driving change

- Regulatory pressures: 54.1%
- Emergence of new business risks: 35.1%
- Increased focus on risk and controls from shareholders or investors: 32.1%
- Demands for greater accountability from stakeholders: 27.1%
- Greater levels of macroeconomic and political uncertainty: 25.5%
- Financial market volatility: 22.9%
- Increased use of offshoring: 17.2%

Internal factors driving change

- Increased focus on risk and controls by senior management and the board: 52.5%
- Focus on cost reduction and efficiency: 35.8%
- Market expansion (e.g. new product development): 31.0%
- Geographic expansion: 30.3%
- Emergence of new operational risks: 24.5%
- Stronger culture of risk instilled within the organisation: 24.5%

“Global Companies are looking to risk and control management to become more strategic and forward looking with a focus on creating as opposed to merely preserving value. These Companies will be looking for a genuinely holistic, integrated, future focussed and process orientated approach to risk and control.”

Economist Intelligence Unit and KPMG
Factors Driving Change (Cont’d)

Internal audit needs to maintain and strengthen its value preservation activities (lower right oval) and move more fully into activities that create value (upper left oval).

Internal audit needs to find new ways to deploy its risk-and control-based skills to help the Bank achieve its strategic objectives and thereby enable value creation.

Adding capabilities that are in keeping with these goals will become increasingly important.

...Enhancing Value Preservation, Expanding Value Creation
Internal Audit Share Forum Highlights

• “Internal Audit is experiencing a shift in its role from providing information to providing interpretation. It is offering and is being expected to offer increased synthesis and analysis of information to help management identify themes, trends, and business challenges.”

• “Boards and Audit Committees are seeking a ‘real time’ overarching view of the control environment from Internal Audit rather than reports on individual areas of the business.”

• “Internal Audit should gather and integrate assurances provided by others to provide a view.”
What are we hearing in the Executive Corridors?

**Reporting**

“I’m inundated with multiple risk and assurance reports that divert my focus from customers and the business.”

**Risk Analytics**

“My current risk models need consistent calibration to convert, manage, and analyze information to achieve the purpose for which they were designed – can’t I do this once?”

**Governance**

“Governance around risk ownership, independent monitoring and reporting, and independent review and assessment (three-lines of defense) is not easily apparent to everyone in the organization.”

**Risk and Control Self Assessments**

“I have to deal with multiple risk and control assessments some at a very granular level. There has to be a better way.”

**Policies and Procedures**

“I have a challenge in communicating policies and procedures to the organization because of the lack of consistency between the documents.”
The Shifting Role of Internal Audit from Providing Information to Interpreting Information – Value Creation
Value Creation

“Leading integrated Internal Audit functions will need to stay ahead of the risk curve rather than simply follow the business, whilst preserving the core compliance and assurance activities senior management and the audit committee require.”

Economist Intelligence Unit and KPMG

“The important step for internal audit is to create and provide its own ‘world-view on a real-time basis.’”

KPMG: Internal Audit of the Future, Financial Institutions Look Ahead

The Challenge for Internal Audit

- How to focus on creating as opposed to merely preserving value
- Defining “value” and how the meaning differs according to audience
- Delivering “value” based auditing
- Keeping the ‘finger on the pulse’, spotting and communicating the big picture risks and future vulnerability to senior management
- Being on top of, even anticipating, change rather than responding to it
- Meaningful relationships with the right people in the business
What does “good” look like in the future?

- Understanding and refocusing on the executive agenda
- Ensuring a clear link from business strategy to internal audit’s focus. The Internal Audit department’s structure mirrors the organization structure
- Expansion of the internal audit department’s focus into new areas (e.g., business planning, liquidity/tax strategy, fraud prevention)
- Having a rapid response unit (to respond to market events as well as company crises)
- Succinct and timely reports identifying trends/themes/future vulnerabilities
- Provision of real time internal audit opinions on state of the control environment and managements control consciousness
- When appropriate, calculating savings from internal audit’s findings

Need to consider:

- Definition of “value” and redesigning internal audit’s focus and approach to suit
- Real time, ‘on demand’ internal audit opinions
IV Integrated Assurance
• How well is the “3-lines of defense model” working in internal audit?
• How is the internal audit department building consensus with management and the Board about how its role should evolve as well as communicating the value of an integrated assurance approach?

The Challenge for Internal Audit:
• Identifying and understanding the assurance universe across internal audit
• Extent of consideration of other assurance providers in internal audit planning and execution
• Duplication of work by different assurance functions creating a “nuisance factor” within the business
• Contradictory views given to executive management

IV Integrated Assurance
### Integrated Assurance (Cont’d)

#### Three Lines of Defense – Components

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<th>1&lt;sup&gt;st&lt;/sup&gt; Line of Defense</th>
<th>2&lt;sup&gt;nd&lt;/sup&gt; Line of Defense</th>
<th>3&lt;sup&gt;rd&lt;/sup&gt; Line of Defense</th>
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<tbody>
<tr>
<td><strong>Primary Responsibility De-Centralized</strong></td>
<td><strong>Oversight Centralized</strong></td>
<td><strong>Independent Assurance of all Other Components</strong></td>
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<td>The business have primary responsibility for identifying, managing and reporting their risks</td>
<td>- The Risk Management Framework (RMF) will provide support to the businesses, review and report key risks to central RMCs</td>
<td>- Internal audit can provide independent assurance of the robustness of the different risk management processes and methodologies</td>
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<td>The businesses are required to help manage certain defined risks through the use of facilities and services provided by specialist risk departments (e.g., Corp Insurance)</td>
<td>- The Board and the RMCs will satisfy themselves that risks are managed cost effectively and to an acceptable level</td>
<td>- Internal audit communicates with external audit and the audit committee</td>
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<td>Group/Support Functions can report their own risks</td>
<td>- Specialist departments will support other parties within the model</td>
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IV
Three Lines of Defense - Accountabilities

First line
- The first level of the control environment is the **business operations** which perform day to day risk management activity.

Second line
- Oversight functions in the company, such as Finance, HR and Risk Management set direction, define policy and help provide assurance.

Third line
- Internal and external audit are the third line of defence, offering **independent** challenge to the levels of **assurance** provided by business operations and oversight functions.
IV
Integrated Assurance (Cont’d)

Three Lines of Defense – Oversight Responsibility

- **1st Line of Defense**
  - Business Lines
  - Specialist Support Units
  - Primary Responsibility/Decentralized

- **2nd Line of Defense**
  - Independent Risk Management Function (RMF)
  - Oversight/Centralized

- **3rd Line of Defense**
  - Internal Audit and Compliance Function
  - Independent Assurance of all Other Components

Board of Directors

Senior Management

Executive Team
Integrated Assurance (Cont’d)

What does “good” look like in the future?

- Integrated Assurance needs the support of the Audit Committee, CEO, CFO, and Heads of Assurance functions
- IA, Op Risk, FinCon and other functions:
  - Share a risk profile
  - Use same technology (risks, issues, etc.)
  - Rely on others' work where appropriate
- Streamline duplicated activities (e.g. Op Risk, Compliance, FinCon, and GIA)
- Continual/ongoing assessment of risks and Internal Audit highlights these to the business on a timely basis
- The Internal Audit plan includes ability to respond rapidly to emerging risks while ensuring coverage of core processes and controls
- “On demand” controls opinion includes risks in the control environment, as well as risks arising in management’s awareness of those risks
- Trends in issues/problematic areas easier to identify and deal with

Need to consider:

- Preparing a business case for Integrated Assurance
- Developing methodologies/techniques to work with other assurance functions
- Collating, evaluating and reporting total assurance activities
- Giving a view on how good the assurance is, as well as where it comes from
Innovation, Technology, & Tools – Continuous Auditing
Continuous Auditing

Two recent developments have accelerated the implementation of continuous auditing and monitoring:
- Significant advancements in technology
- Impact of regulatory changes, such as Sarbanes-Oxley.

The Challenge for the Internal Audit
- Re-evaluate risk assessment and audit planning processes, especially the cycle-based approach
- Use of technology and continuous auditing techniques
- Balance breadth of monitoring with ‘deep dive’ audits
- Make effective use of CAATs
- Use audit technology as “enabler” not “straightjacket”

Recent survey results support the trend towards continuous auditing.
Continuous Auditing (Cont’d)

What does “good” look like in the future?

- Use of analysis tools to link disparate financial systems and allow inspection of every transaction in real time
- Deliver value by identifying errors and control violations as they happen
- Automation of the analysis and testing of auditors and fraud examiners over every transaction within multiple financial systems
- Continuous auditing and continuous monitoring incorporated into an Integrated Assurance model
- Continuous Monitoring Tools can be handed over by internal audit to the business to become part of their continuous monitoring efforts

Need to consider:

- Developing CA tools to enable IA to spend time on analysis not testing
- Assisting the business to develop CA tools that would allow internal audit to focus on other strategic areas
- Setting up a dedicated CA team within GIA
Talent Management
The skills, experience, and capabilities of the Internal Audit resources are changing.

The Challenge for Internal Audit

- Recruiting and retaining the right people—particularly from within the business
- Marketing internal audit as a valuable, viable career (or career step)
- Right skill mix for new products, services, and risks
- Nurturing key internal audit team members through leadership development programs and individual development plans
- Performance management system linked to business and internal audit strategy

Source: Economist Intelligence Unit 2007
The Challenge for Internal Audit

- Appetite for internal audit to contribute to a Single View of Risk (SVR)
- Adequacy of skills within the internal audit department to participate in SVR approach
- Internal audit independence through process
- Provide independent assurance over the risk management process
Who we are:

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OBJECTIVE

LIB’s main objective is to secure our clients the widest and best cover with outstanding insurance companies with lowest possible cost and we pursue this with a passion that is unrivalled with our market.

Regulatory Bodies:

- Insurance Broking
- Risk Management
- Consultancy Services
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