

INTERNAL AUDIT HOT TOPICS

# THE INTERNAL AUDIT AGENDA



IDEAS | PEOPLE | TRUST



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# THE INTERNAL AUDIT AGENDA: WELCOME

The role of Internal Audit continues to be recognised as a fundamental part of enabling and embedding good governance. As the risk landscape changes, becomes more complex, and with increasing regulation, many organisations are looking to Internal Audit to provide 'assurance' and advice as 'risk and control' experts. This role has evolved over the past five years, increasingly to one in an advisory capacity – both protecting and creating value in the business.

Internal Audit has an opportunity to be a leader in this assurance agenda. We are in a privileged position to look across the risk landscape of an organisation and advise on the 'what', 'where', 'when' and 'how' of assurance needs. As the role of the 'second line' compliance functions grow, on the back of topics such as data privacy, cybersecurity, ESG and risk, ensuring that you have the right balance of assurance across the organisation will be critical.

Internal Audit teams will be thinking carefully about where they can best contribute to managing risk and supporting the success of their organisations. This document sets out some of the key areas that Internal Audit should be considering when thinking about that wider assurance landscape.



# CLIMATE CHANGE



The wide ranging negative impacts of the current climate change projections are alarming, and have provoked governments, investors and customers to change their expectations of business.



The implementation of the Task Force on Climate-related Financial Disclosures (TCFD) whose goal is to create a uniform standard for corporate climate-risk disclosures to help companies take action to address climate change has led the Hong Kong Stock Exchange (HKEx) to publish the Guidance on Climate Disclosures (Climate Disclosures Guide) in November 2021. The Climate Disclosures Guide provides guidance for the Hong Kong listed companies on how to comply with TCFD's recommendations regarding climate-related disclosures in a company's ESG report and assists companies in assessing climate related risks and opportunities.

Continuing changes in regulatory policy are expected to facilitate a transition to a low carbon economy, which will present opportunities for green businesses, and risks for others who face pressure to adapt their environmental practices and collate and present information on them to comply with increased regulation as well as to inform customers, investors, and lenders who are increasing incorporating ESG criteria into their credit ratings and investment decisions.

With the increase in ESG investing, the demands of ESG disclosure are intensifying as global warming and human-rights issues are seen to pose new risks for companies. Businesses are making wide-reaching changes to their operating model not only to meet regulatory requirement, but also to address issues that many ESG investors are concerned about.



## HOW INTERNAL AUDIT CAN SUPPORT

- ▶ Provide valuable assurance around the environmental framework in place to measure and monitor achievement of carbon commitments
- ▶ Provide assurance on the environmental considerations built in to purchasing decisions and key projects, for example, capital builds or transport contracts
- ▶ Proactively assist to understand and transit to the new reporting regime
- ▶ Facilitate assessment of climate risk and opportunity
- ▶ Validate the transparency and completeness of reporting, and the assumptions, calculations, data sets and evidence used in climate change reporting, in response to new regulations.



# GOVERNANCE



The latest Corporate Governance Code (CG Code) update, born out of further underpinning the quality of our markets, and strengthening Hong Kong's role as Asia's premier international financial has raised expectations around corporate governance. The CG Code set out wide ranging reforms to the corporate governance regime, including corporate culture expectations, directors independence enhancement, transparency of Board and corporate diversity and information, and ESG disclosure and standards. Directors will be required to carry out their role more effectively with heightened regulatory responsibilities.



With the latest CG Code generally already taken effect in financial year beginning 1 January 2022, listed companies must promptly launch review as to the existing corporate governance practices and adopt corresponding measures and policies in response to the latest CG Code enhancement.



## HOW INTERNAL AUDIT CAN SUPPORT

Internal audit can support the organisation to:

- ▶ Provide assurance that the impact of latest CG Code has been evaluated and effective plans are in place to achieve compliance
- ▶ Develop specific benchmarks and standards for corporate governance and management processes
- ▶ Provide recommendations to management on effective mechanism to ensure compliance and risk management culture is instilled in business processes and decision making level and culture-related risks are identified
- ▶ Streamline controls, alongside with other business functions in assessing, monitoring and providing assurance on corporate culture and diversity and the associated risks and opportunities



# RISK MANAGEMENT



A strong risk management framework supports in:

- ▶ Achievement of objectives
- ▶ Creating and protecting value
- ▶ Assisting organisations with ensuring compliance
- ▶ Enabling informed decision making (i.e. informed risk taking)
- ▶ Improving efficiency of operations
- ▶ Reducing the likelihood of failure.



Organisations are experiencing unprecedented change and require to take agile decisions. A strong risk management framework will help ensure that these decisions are taken in a robust, controlled manner which maximises the likelihood of objectives being achieved.



## HOW INTERNAL AUDIT CAN SUPPORT

Internal audit can support in embedding risk management through providing workshops to raise awareness of the policy and identify and assess risks and can provide assurance that:

- ▶ An effective risk culture has been embedded and everyone understands and plays their part in risk management, with the risk management framework consistently applied
- ▶ Risk management is a part of all operations and systems, integrated with performance management, accountability and decision making structures
- ▶ Risks are identified, analysed and evaluated in line with policy and risk appetite
- ▶ Mitigating actions and reactions are planned and taken in a timely way with clear accountability
- ▶ Risks, relating controls and further actions are reported effectively.



# TREASURY



An effective treasury function will ensure that the business has the right amount of funding and liquidity to meet obligations when they fall due but can also make a valuable and important contribution to wider financial risk management across the business.

Not only is it important to have a clearly defined remit for the treasury function with appropriate delegated authority and risk limits, but the high-value nature of treasury transactions demand a robust and effective control framework that can be delivered on a timely and consistent basis.



## HOW INTERNAL AUDIT CAN SUPPORT

In the context of these changes to the risk landscape internal audit reviews of treasury can add value by considering:

Has treasury policy been subject to review to ensure that the remit of treasury remains appropriate when considering the risks facing the business and is this clearly defined? Given the changing risk landscape, treasury departments are often taking wider responsibilities. For example a business with a material exposure to power prices, may involve their treasury function in hedging the commodity element of power exposures, utilising their access to financial markets (banks and other financial counterparties) and the skills available in the team to manage financial risks.

Does the control environment remain robust, especially where remote working remains in effect, for some or all elements of treasury activity? In recent years, the functionality, flexibility and cost effectiveness of treasury systems have all improved. Not only do system-based controls for treasury management deliver a more efficient process for managing treasury transactions, but if implemented correctly can also make a significant difference to the strength of the control framework. The integration between systems is a key consideration here, the need for robust system and user access controls, as well as appropriate continuity, system service and support arrangements.



The risk landscape for treasury is changing:

Strategic and financial risks, along with cybersecurity, will dominate the risk landscape for the coming years.

Treasury function today is focused on ensuring there is a capital structure in place that fulfills their organization's underlying goals as they navigate the deep disruption occurring across all economic sectors.

Companies are also very aware of the extent of cyber attacks and attempts at fraud and data theft of their organization's financial and customer data.

Remote working has necessitated changes to the control environment operated for many treasury functions. These changes are sometimes subtle, and have not been fully considered. This is especially true where manual controls exist and it can be harder to operate or evidence these controls, increasing the risk of fraud or error.

# DATA MANAGEMENT AND DATA QUALITY



In our highly connected world - where our interactions with institutions, public services, organisations, and with one another - data quality and the management of information is critical to success.

Having information that is of a high level of quality (including being accurate, complete, relevant, up to date and secure) is becoming increasingly crucial in the delivery of products and services, in ensuring our ability to communicate and connect, and in building consumer and public trust.



While data management is not a new topic, it continues to increase in importance as organisations move from operating models reliant on analogue processes and traditional customer communications methods to more efficient, effective and innovative ways of working, enabled by digital technology.

Data is now considered a key asset for any organisation, and to deliver value it needs to be of a high level of quality. This supports efficient operations, delivers increased stakeholder value and supports better decision making.

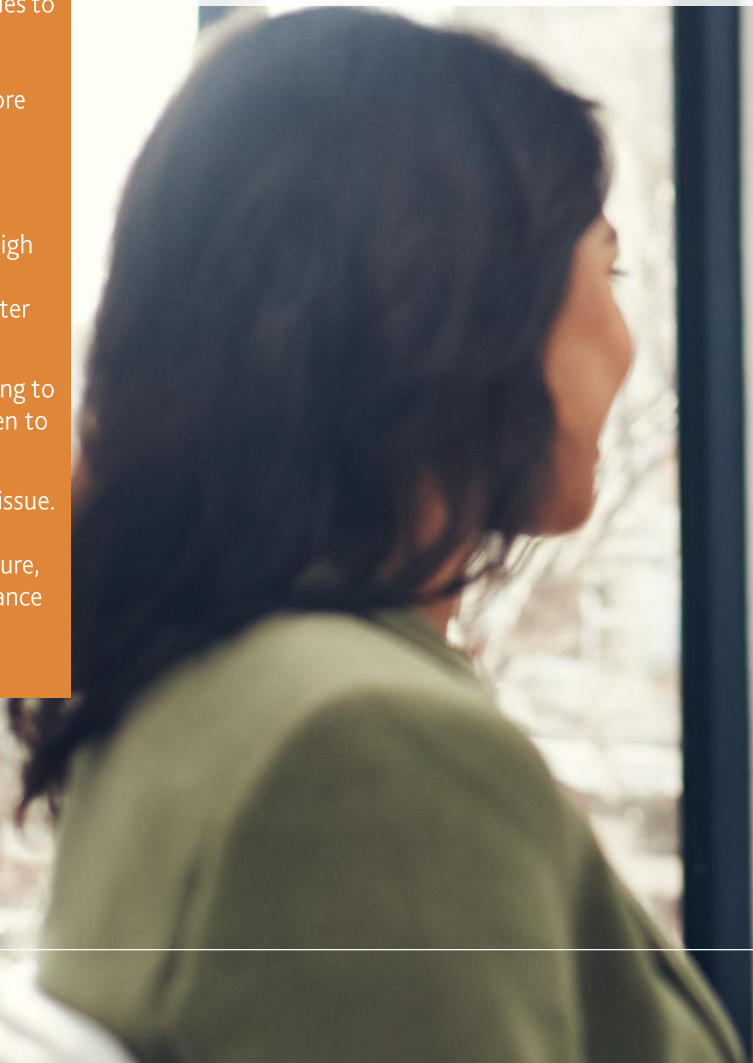
As a result, leaders need to understand the risks relating to data, and ensure that appropriate steps are being taken to achieve a high level of data quality.

Data management can no longer be considered an IT issue. It presents challenges and opportunities all across organisations, and relies as much on organisation culture, robust policies and procedures, controls and performance management as it does on the technology itself.



## HOW INTERNAL AUDIT CAN SUPPORT

- ▶ Assess whether the data culture within the organisation supports effective data management
- ▶ Provide assurance on data management policies, standards, procedures and practices
- ▶ Provide assurance on data quality assurance procedures, and data quality improvement activities
- ▶ Assess the quality of the organisation's data, comparing against standards and good practice
- ▶ Introduce the organisation to good practice master data management principles
- ▶ Facilitate training and development sessions to improve the organisations understanding of good data management.





# CONTRACT MANAGEMENT



The International Association for Commercial and Contract management estimates that poor contract management costs companies an equivalent of 9% of revenue. Getting the right contracts in place (on both the buy and sell side) along with a robust, commercially-focused governance framework to manage these across the lifecycle is an opportunity to optimise outcomes and gain competitive advantage.



Reliance on third parties to deliver business critical services is a fundamental reality of today's business world, yet most organisations struggle to realise the value expected from these relationships. In addition, evolving business needs are affecting what businesses require in terms of contract portfolios and agile contract management processes are essential in ensuring the right contractual arrangements are in place to secure an efficient supply chain, and manage change.



## HOW INTERNAL AUDIT CAN SUPPORT

Internal audit can provide valuable assurance that:

- ▶ Procurement and Contract Management functions are operating effectively
- ▶ Suppliers are complying with contracts, fulfilling their obligations and billing accurately
- ▶ Supplier performance is transparent and monitored effectively
- ▶ Contract changes are managed effectively and don't diverge from founding commercial principles
- ▶ Transition to new suppliers is managed effectively.



# FRAUD



Preventing fraud is a complex challenge, complicated even further by today's volatile risk landscape. As organizations act quickly to navigate change, perpetrators look to exploit the potentially widening cracks in fraud defenses. Although several studies show that the proportion of organisations experiencing fraud has remained relatively steady since 2018, most organisations experiencing fraud reported that the most disruptive incident came via an external attack or collusion between external and internal sources. Hackers and organised crime rings are among the most common external perpetrators. Organised crime groups are collaborating and becoming more specialised and professional. Combating fraud today using traditional prevention tools such as codes of conduct, training and to contain internal fraud are not enough.



Reported cases are just the tip of an iceberg when it comes to fraud. The Covid-19 pandemic and the associated lockdowns have brought change and challenge to internal control environments. Organisations have been tasked with delivering in new working environments, and this has presented additional fraud risk to identify and manage. Fraudsters are developing increasingly sophisticated tactics at an alarming rate, and the mass digitisation of the workplace has outpaced many firms' ability to secure themselves against exploitation. It is therefore very important, now more than ever, that businesses implement proactive fraud planning and response strategies.



## HOW INTERNAL AUDIT CAN SUPPORT

Internal audit can play an important role in raising awareness of fraud risk and identifying and assessing fraud risks through training and facilitation of workshops. Internal audit can also provide valuable assurance that:

- ▶ There are appropriate and up to date counter-fraud strategies in place
- ▶ Effective fraud risk assessments have been carried out
- ▶ Identified fraud risks have been mitigated effectively, with appropriate controls in place and regularly tested
- ▶ Controls are amended appropriately when new fraud risks emerge.



# PEOPLE



Attracting, retaining and developing the right people, and deploying them effectively, is critical to the success of any organisation. Inclusion and diversity initiatives are also an important part of optimising the people resources, for improved decision making, and also to manage reputational risk in light of requirements to report on gender and ethnicity pay gaps.



Covid-19 have impacted on the ability of Hong Kong companies to compete for global resources, and employees have shifting expectations around working life post Covid-19, expecting more flexibility and a better work life balance than before. Many organisations are working on far reaching workforce deployment change programmes.



## HOW INTERNAL AUDIT CAN SUPPORT

Internal audit can provide valuable assurance around workforce planning, recruitment, reward packages, and people development processes, and in particular on changing business requirements and imperatives around how and where resources can be deployed, advising on the decision making around and execution of workforce change programmes.

Internal audit can also provide scrutiny of the planning and achievement of diversity and inclusion objectives and over the data used to report on inclusion and diversity targets.

# SUPPLY CHAIN



A supply chain is about getting the right thing, to the right place, at the right time, in the right quantity and quality for the right price. It covers the spectrum of activities that starts with raw materials and ends with delivery to the end user. Supply chains are becoming more complex as they stretch further across the globe; COVID has highlighted the frailty of the models that rely on predictable outputs and movement. All too often companies were reliant on single suppliers often for critical or scarce products/goods/components or materials. Supply chain disruption is one of life's certainties. An ability to react quickly, stabilise situation and return to a steady state will minimise costs, reputational damage and risk of losing customers to competitors.



## HOW INTERNAL AUDIT CAN SUPPORT

- ▶ Assess maturity of SC Management and SC Resilience
- ▶ Advise on managing supply chain risks, supplier risk and association continuity management
- ▶ Advise on suitability of the SC operating model
- ▶ Advise on component functions of SC Management including procurement, supplier management, contract management, inventory management, logistics planning and management
- ▶ Advise on creating a more resilient supply chain
- ▶ Assess risk management of risks created by suppliers.



The impact of COVID is still being felt, directly and indirectly. Full and partial shut downs of manufacturing facilities, logistic nodes and ports affected ability to both satisfy customer needs and plan with suppliers. The closure of ports, backlogs of ships waiting to berth meant that containers were not being unloaded in time to return to ports of origin. The driver shortages across the world, rising fuel prices, decarbonisation are adding costs to the supply chain to the point that some suppliers are opting to cease trading. The expectations of customers are not reducing, with the desire to know where consignments are at all times being the standard. Digitalisation of the supply chain is becoming increasingly important to support customer service, to manage the complexity and support business functions such as finance and business continuity.

Hong Kong companies have not been immune to the impact of COVID; arguably the impact has been felt across the globe. The construction sector, for example, was affected as demand for raw materials including steel, timber, PVC and chemicals exceeded supply.



# CYBER RISK



Cyber security remains a corporate priority. Businesses depend more and more on digital technology to operate efficiently and deliver for their customers and clients. Cyber criminals are continuously evolving their methods and their use of technology.



Over the last 12-18 months cyber attacks have risen to record levels, as reported by the National Cyber Security Centre (NCSC) in their Annual Report 2021. One of the most notable cyber security issues stems from Covid-19 and the impact remote working has had. The mass shift from office-based work to working from home has changed and increased the opportunity for cyber attacks to occur. For many organisations this has brought to light the need to modernise technology and accelerate digital strategies.



## HOW INTERNAL AUDIT CAN SUPPORT

- ▶ Identify and assess weaknesses in cyber security and find any issues around compliance with the latest regulations
- ▶ Utilise 'best in class' cyber technologies to remediate identified issues and improve cyber resilience
- ▶ Advise on appropriate protection levels around critical assets
- ▶ Design appropriate cyber responses and strategies
- ▶ Provide robust, size-appropriate managed services built on proven technologies.



# TECHNOLOGY RISK & GOVERNANCE / CLOUD



Organisations are under pressure to implement technology that drives efficiencies and supports new ways of working. Technological change must be implemented securely and be supported with appropriate governance, testing and training arrangements to ensure the value is realised and risks are mitigated.



The global pandemic accelerated the pace of digital transformations for many organisations. The move to remote working has brought about significant change to how technology is used. For many, this has meant increasing reliance on third parties to manage technology in the cloud, which can reduce control and increase risk.



## HOW INTERNAL AUDIT CAN SUPPORT

- ▶ Identify and assess weaknesses in cyber security and find any issues around compliance with the latest regulations
- ▶ Utilise 'best in class' cyber technologies to remediate identified issues and improve cyber resilience
- ▶ Advise on appropriate protection levels around critical assets
- ▶ Design appropriate cyber responses and strategies
- ▶ Provide robust, size-appropriate managed services built on proven technologies
- ▶ Provide independent assurance over service organisation controls for services outsourced to third parties

# PROGRAMME MANAGEMENT



An organisation should always have a clear understanding of the purpose of the project. The objectives and scope should be specifically aligned to one or more corporate objectives and supported by a detailed, proportionate business case giving clarity of the costs and benefits. By having these foundations in place will help give confidence that the project is valid and that progress against the business case can be proactively tracked. Ultimately an organisation's approach to both return on investment and benefits realisation need to be integrated with business planning activities as this will help ensure a robust management focus beyond the specific programme or project. Without this focus then projects will struggle to communicate their value and ultimately how they are being successful.



## HOW INTERNAL AUDIT CAN SUPPORT

- ▶ Provide support and advice on the end-to-end project management delivery process from 'Idea to benefits realised'
- ▶ Provide assurance on the identification and development of projects from business case development to approval
- ▶ Developing/Reviewing benefit management framework, processes, and procedures, based on industry good practice and to delivery business value
- ▶ Training and development workshops to improve the organisations understanding on Benefit Management and how this can be effectively implemented.



The pressure to deliver successful change is ever increasing, and organisations are faced with significant economic and commercial challenges as well as increased regulation and legislation, when trying to deliver their portfolio of projects.

Return on Investment and business benefit delivery are fundamental to making the 'right' investment decisions and justifying the inclusion and progression of every project.



# CULTURE



Corporate culture refers to the beliefs and behaviours that determine how a company's employees and management interact and handle outside business transactions. Often, corporate culture is implied, not expressly defined, and develops organically over time from the cumulative traits of the people the company hires.

Understanding the true culture of an organisation can get to the heart of what helps or hinders an organisation, and can help detect early warning signs of broader organisational issues.



There are increased expectations around corporate culture, with various forms of movements across the world and broader equality issues, ethics and values receiving heightened media and business attention.



## HOW INTERNAL AUDIT CAN SUPPORT

- ▶ Internal audit can compare espoused with actual behaviours to assess whether organisations are living their values, and provide assurance over how organisations maintaining ethical and cultural values in the post-pandemic world. They can also conduct root cause analysis of silo based mentality and negative behaviour and identify compliance issues stemming from ethical lapses (not arising from process or operational bugs)
- ▶ A full audit typically involves an assessment of whether the organisational values are fully in evidence in business decisions and operations and incorporated in key processes including governance, communication, recruitment, induction, training, performance management and reward structures
- ▶ A partial audit may also be considered. This aims to provide assurance on specific matters relating to the culture of the organisation, and can also be used to investigate whether there are underlying cultural reasons for recurring issues. Where a process is failing repeatedly, we can conduct root cause analysis to help identify specific reasons for issues occurring and whether there are cultural drivers for unsuitable behaviours.





# ORGANISATIONAL RESILIENCE



## WHY IT'S IMPORTANT?

Resilience is the business' ability to change or adapt during times of stress, disruption, or uncertainty.

It integrates the concepts of risk, crisis management, business continuity planning and organisational leadership and learning to provide a platform for developing more robust and agile organisations.

It is vital that organisations have the ability to prevent, adapt and respond to, recover and learn from operational disruption.



## HOW INTERNAL AUDIT CAN SUPPORT

Internal audit can provide assurance on where the organisation is on its implementation of resilience and whether plans and strategy for implementation look to deliver expected outcomes, and the extent to which broader requirements such as incident response, third party management etc. are incorporated. It can also provide assurance over whether we have adequate due diligence over third party resilience.

Internal audit can use multiple data sources to analyse transaction volumes, customer base composition etc. and define impact tolerances and then using simulation, desktop exercise or both, determine the organisations ability to remain within those tolerances, and where failures are identified in the scenario testing, assist with the design of a mitigation strategy for remediating those failures.



## WHY IT'S CURRENT?

Many viewed COVID-19 crisis as a 'black swan' incident – owing to its rarity, extreme impact and retrospective predictability. However, some believe the pandemic was wholly predictable, and others had predicted it— a white swan if ever there was one.

More than business continuity planning, operational resilience encompasses a holistic and strategic framework. It is a governance and risk management responsibility that boards must address to enable them to survive and thrive in an increasingly hostile environment and adapt to changing patterns and disruptions. For example, the economic disruption caused due to the coronavirus crisis.



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