The New Chief Audit Executive

Leadership in the risk intelligent organization

Shayne Gregg CISA, CMC, CISSP, CA(NZ)
Partner, Enterprise Risk
Deloitte & Touche
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Introduction

The recent spate of business crises and our organizational responses to them have highlighted a surprising misconception - that risk is the opposite of reward. It is not: loss is the opposite of reward. Risk simply represents the possibility that a loss or reward will occur. For Chief Audit Executives and their staff, this point marks a crucial and highly personal distinction.

Just as business success will be determined by risk intelligence (see "Identifying the CAE's Risk IQ” side bar) at the strategic level rather than risk aversion on a tactical level, so too, will internal audit’s ultimate value be determined by strategic contributions to the business rather than through tactical accomplishments (i.e., executing the annual audit plan) alone.

Amid the great economic uncertainties facing companies and the mounting pressures bearing down on internal audit functions, this much is certain: the Chief Audit Executive has a unique opportunity to assume and/or solidify their role as a strategic business partner to the CEO and CFO.

Those who leverage this opportunity through strategic risk management endeavors, innovation (such as continuous auditing activities or data analytics, etc.), board committee relationships and other strategic priorities will help lead their companies to greater success while enjoying more rewarding career opportunities. Internal audit executives and managers who choose to reside on the more tactical side of their job description may enjoy less financially rewarding career opportunities; however their services will remain in high demand for the foreseeable future. To be sure, both choices are valid and a matter of personal preference.

Regardless of which end of the positional spectrum internal auditors choose to occupy, the road ahead will be difficult. Given the regulatory and economic conditions, as well as the recent post-Sarbanes-Oxley (SOX) focus on financial internal controls, all internal auditors will need to:

- Do more work with fewer resources;
- Conduct their activities in more and more complex technology and data environments; and
- Work with increasingly ‘audit-aware’ operational business partners whose demands for real-time audit and risk information are swiftly growing.

KEY TAKEAWAYS

1. Recent corporate scandals, the ensuing worldwide regulatory response and recovery from the global financial crisis exert new pressures on chief audit executives (CAEs) and their internal audit (IA) functions.

2. This pressure, more so than ever, forces CAEs to make a tough choice about their role: remain traditional auditors focused on executing their audit plan, or to elevate their role, particularly in the area of risk management, to that of a strategic business partner on the senior leadership team.

3. Regardless of their decision, CAEs must contend with the challenges of doing more with less, continuing to tame unruly internal controls and data environments, and working with increasingly technology-savvy and "information curious" business partners.

4. Successfully addressing these demands requires a combination of leadership, processes and tools from internal audit. These include, most prominently, a stronger role in boosting the organization’s overall risk management capabilities as well as greater use of automation and analytics, such as continuous auditing, to deliver greater efficiency and effectiveness.
Why the Choice Exists

Speaking to CEOs and CFOs about their primary needs represents one of the surest ways to assess the current state of internal audit. The challenges that keep C-suite executives awake at night help explain why Chief Audit Executives face a critical juncture.

Recent economic conditions have resulted in CEOs and CFOs calling for leadership in the business to cut costs, reduce headcount, and seek new value – to “find money… fast.” Internal audit leadership is not immune from this directive: teach the business how to take ownership of internal controls monitoring, reduce compliance costs, enable real-time auditing and risk management, redeploy current internal audit staff and, above all, add value.

These demanding and, in some cases, seemingly contradictory requests should sound familiar to anyone who has served as a senior internal audit executive in recent years.

This mounting pressure arises from three drivers: macroeconomic pressures; a procession of corporate crises, regulatory responses and our ensuing compliance efforts; and the changing nature of both organizational technology and the operational workforce that relies on these systems to support their business processes.

Identifying the CAE’s Risk IQ

Fifteen years ago, senior executive teams explored emotional intelligence in an effort to bolster organizational competitiveness by identifying high-potential employees and future leaders. Today, “companies that are most effective and efficient in managing risks to both the existing value-creation activities and to future profitable growth opportunities will, in the long run, outperform those that are less so.” In other words, risk intelligence now serves as the basis for competitive differentiation.

At its foundation, the risk intelligent company manages risk in a holistic way; these companies not only prevent, detect and correct critical risk issues quickly, they use their risk management capabilities to improve organizational flexibility so that strategic opportunities can be leveraged.

The Chief Audit Executive can and should play a central role in the risk-intelligent company. How? To start with, by addressing the following questions, according to Deloitte’s “The Risk Intelligent Chief Audit Executive” white paper:

- Are we speaking the language of management? Are we assessing risks to future growth (value creation) or are we solely focused on the protection of existing assets?
- Are we assessing risks in isolation or are we looking at how these risks may interact and cascade?
- Is there a uniform framework to align the various risk specializations regarding governance, risk, and compliance assessments so we can reduce the cost burden on the business? For example, can we reduce the number of risk and control self-assessments?
- Do existing risk assessments reliably and adequately assess inherent and residual risk exposures?
- Do we have the means to assess whether residual exposures are within the risk appetite of the company?
- Is there a robust risk mitigation process?
The Swinging Risk Management Pendulum

Just as the impact of the global recession affected internal audit departments, so, too, has the source of this particular economic downturn. The financial services-sparked credit crisis that helped cause the recession resulted from insufficient strategic risk management capabilities. As a result, regulatory agencies around the world have begun requiring corporate executive teams and their oversight boards to demonstrate stronger strategic risk management.

For example, in late December 2009 the U.S. Securities and Exchange Commission (SEC) approved enhanced disclosure requirements concerning the risk information that publicly listed companies provide to shareholders. Corporate boards now need to more clearly identify how they want to oversee not only the operational risks companies face, but also regarding credit risks, liquidity risks and other high-level “material” risks. This need ensures that boards will expect more risk information from CEOs, CFOs and, especially, CAEs.

Thanks to Enron, WorldCom, Parmelat, Royal Ahold and other corporate scandals and the new regulatory rules such as the Sarbanes-Oxley Act enacted in their wake, companies became much more focused on financial reporting risks. Specifically, the business process internal controls that help limit such risk. And internal audit initially spearheaded the bulk of these efforts, many of which resulted in over-management of internal controls.

Similarly, other regulatory bodies have continued to increase their compliance requirements with the vision of protecting the public where they are unable to do so themselves. An ongoing action creating significant operational risk mitigation and compliance control activities.

Arguably, companies have gone overboard in their efforts to eliminate the possibility of all financial, operational and compliance problems: the same risks were being managed multiple times. There remains plenty of scope for control rationalization and automation in these internal control systems.

This approach, which did not necessarily extend to strategic risks (as so painfully demonstrated by the credit crisis), proved inefficient at a highly inopportune time – just as the worst global recession in 70 years took hold.

Today, the overall risk management focus within global businesses has swung toward strategic risks. “Internal audit really needs to shift from an exclusive focus on the traditional areas of financial, operational and compliance risk and get more involved in understanding the overall strategic business risk areas,” notes ACL Services Ltd. Vice President John Verver. Managing internal audit’s traditional risk terrain remains a strict requirement, Verver asserts; however, given current economic, regulatory and competitive conditions, these traditional risk areas need to be managed in a much more efficient way without sacrificing a shred of effectiveness, through the application of technology.

Given the current technology environment in most organizations large and small, achieving greater auditing efficiency and effectiveness can be difficult. Companies have invested billions of dollars in the past 15 years upgrading their processes and technology systems. These systems remain ripe for data integrity errors. The foundational fuel that runs these systems, data, still requires cleansing.

The Audit-Aware Business

The need for more efficient internal audit and risk management activities is also driven on a more personal level by the board, executive teams and operational managers.

The board, thanks to a variety of new regulations, now understands that they have a crucial responsibility to understand all of the key risks their companies confront. As a result, corporate directors are requesting much more risk-related information and education from their CEOs, CFOs and CAEs.

Within the operations of the business, executives – who have grown more accustomed to business intelligence tools and real-time performance management reporting – increasingly want real-time risk information from internal audit. The adoption of enterprise risk management (ERM) programs and
centralized governance, risk management and compliance (GRC) efforts illustrates the growing value of real-time risk information.

The new generation of managers are also much more technologically savvy and information curious. Combine this with the post-Sarbanes demand for much greater individual accountability for risk management in their business process areas, and it becomes clear why operational partners are demanding more information, and instruction, from internal audit and compliance functions. The new audit-aware and technologically competent business leader will use any and all of the tools at their disposal to find the risks (both loss and opportunity) faster. Further, they will also seek out strong, strategically-minded business partners to help them demonstrate value and provide confidence to the leadership of the organization.

**CAEs Now Require CEO Skills**

For internal audit the evolution toward a more audit-aware business poses the opportunity for a loss or a reward. On the negative side, IA functions already struggling to complete existing workloads may buckle under the pressure of additional requests for information and analysis from increasingly risk-focused and audit-aware operational partners.

Conversely, Chief Audit Executives intent on establishing their function’s value as a strategic business partner can leverage a unique opportunity to provide additional risk insights, given their visibility into, and understanding of, their enterprise’s holistic risk management activities. Doing so requires a deep and broad range of skills and capabilities.

“One of the keys to success is the ability to think strategically,” writes Korn/Ferry International’s Charles Eldridge and Paula Park. “The CAE must understand the strategic and philosophical issues that drive the business forward, while working closely with the CEO, CFO and other senior executives. It is also essential to understand the challenges that the audit committee faces…”

Consider some of the following descriptions of job specifications for recent CAE position openings at leading companies to get a feel for just how broad and deep the CAE skill set now extends:

- “Must demonstrate a solid understanding of the company’s business, core strategies, risk appetite and risk tolerance.”
- “Must be willing to raise difficult issues with senior management and the audit committee - even if such actions prove unpopular.”
- “Must partner with senior management and the audit committee to help them fulfill their broad responsibilities for effective governance.”
- “Must be able to think strategically about the internal audit function, its mission and its strategic resources, including attracting highly qualified staff.”
- “Must be seen as business partner rather than ‘corporate cop’.”

The complete specifications for CAE openings at companies that treat the position as a strategic business partner read very much like a job description for a new CEO.

Not surprisingly, there are recent signs that the strategic-minded, business-aware CAE has become an increasingly common stepping stone to the CFO position. “You have a chance to really learn and help improve the business,” Michael Fung, CFO of Wal-Mart’s U.S. stores division and a product of the retailer’s internal audit function. “You build relationships with the board and the major business leaders. You can move internal audit to more value-added processes. And it builds your ability to manage people and work with cross-functional teams.”

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2. Internal Audit Comes of Age,” by David McCann, CFO.com, June 10, 2008.
Efficiency Demands Confront Everyone

The internal audit role that Fung describes is one of two options currently confronting IA executives: they can choose to fill that seat at the senior decision-making table or not. Assuming the role of strategic business partner requires IA executives to take a prominent role in boosting their organization’s risk intelligence. Electing not to fill that role, again, remains a perfectly valid decision albeit one with the potential for less career growth beyond internal audit.

Regardless of the outcome of this personal decision, the vast majority of CAEs and internal audit functions face a similar set of challenges that require them to ply their craft with greater efficiency and effectiveness. Addressing these widespread challenges, as The IIA President and CEO Richard Chambers laid out in a keynote address that identified priorities for internal auditors, requires numerous steps, including the following:

- Aligning internal audit coverage to meet new expectations.
- Realigning skills to address new requirements.
- Coping with diminished resources.
- Demonstrating value and adding to the bottom line.
- Maintaining stature with the audit committee; and perhaps most important,
- Leveraging technology to achieve greater efficiencies.

Why is the final priority so important? Because technology can help internal audit functions achieve each of the other priorities.

“When internal audit makes greater use of automation, analytics and continuous auditing, it demonstrates its value as a highly effective and highly efficient contributor to the company’s overall risk management program and its bottom line,” notes John Verver of ACL.

For example, when Palomar Pomerado Healthcare (PPH) District Audit Officer Tom Boyle implemented GRC software to enable continuous auditing within his function and continuous monitoring of internal controls by an operational group, he helped the largest healthcare district in the U.S. reduce costs and strengthen its overall risk management capabilities by helping to make his operational partners more audit-aware.

Following cutbacks as well as new regulatory requirements in recent years, Boyle’s department, like the majority of IA functions, was forced to do more with less. By instituting software to automatically scour transactions for errors, he replaced the need for manual (and much less effective) reviews with automated, timely reviews. However, by enabling operational business partners to use the monitoring tool, he empowered them in two ways. “The primary objective is to identify errors,” Boyle reports. “Second, and this is where the major value resides, this is a terrific analytic tool that gives operational people accurate and real-time information on how their various healthcare plans are performing.”

By taking a leadership role as a business-aware auditor, Boyle is helping the rest of his organization become more audit-aware. By doing so, he is freeing his own IA resources to focus on other priorities, like completing the annual audit plan (one he eventually believes will be largely replaced through continuous auditing) and focusing IA attention on areas of high strategic risk – a far more exciting and value-added endeavor for many developing internal auditors.

Boyle and PPH are not alone. Other internal audit functions are leveraging automation to gain efficiency gains – Talecris Biotherapeutics leveraged continuous auditing and monitoring technology to revamp its purchase-to-pay (P2P) cycle, for example,3, and bolster strategic risk management capabilities.

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Same Role, New Opportunities

Auditing automation delivers one additional benefit, which is particularly valuable in light of a highly volatile economic picture: sustainability.

By storing practices, knowledge and data in a user friendly and easily accessible system rather than solely in an individual’s brain, internal audit functions are better positioned to manage the types of significant changes that are occurring with greater frequency today: organizational restructuring, staff reductions and the departure of top internal audit talent for more rewarding jobs.

It could be argued that few functions are sustainable in an organization if they are not aligned closely with the vision and goals of the CEO and CFO.

Whether or not the current risks confronting CAEs and internal audit functions today turn out to be rewards or losses tomorrow depends, largely, on how effective – and sustainable – their responses to current pressures are today.

Shayne Gregg  CISA, CMC, CISSP, CA(NZ) Partner, Enterprise Risk, Deloitte & Touche

Shayne Gregg is an Enterprise Risk partner within the Vancouver office of Deloitte, with specific responsibility for the Assurance Solutions practice area in Canada. He has over 20 years experience providing risk consulting and assurance services to Deloitte’s largest clients in New Zealand, Europe, Canada and the US.

Aside from his practice management responsibilities within Deloitte, Shayne now spends a lot of his time working with senior executives and board members to understand their biggest risks and concerns, and produce innovative strategies and solutions from across the spectrum of Deloitte services and people.