

The Future of Internal Audit?

NSW AEN Members Meeting

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"Financial services firms face a sea change in how they approach risk governance. Internal audit has a major role to play in this change."

~ EY Internal Audit Practice

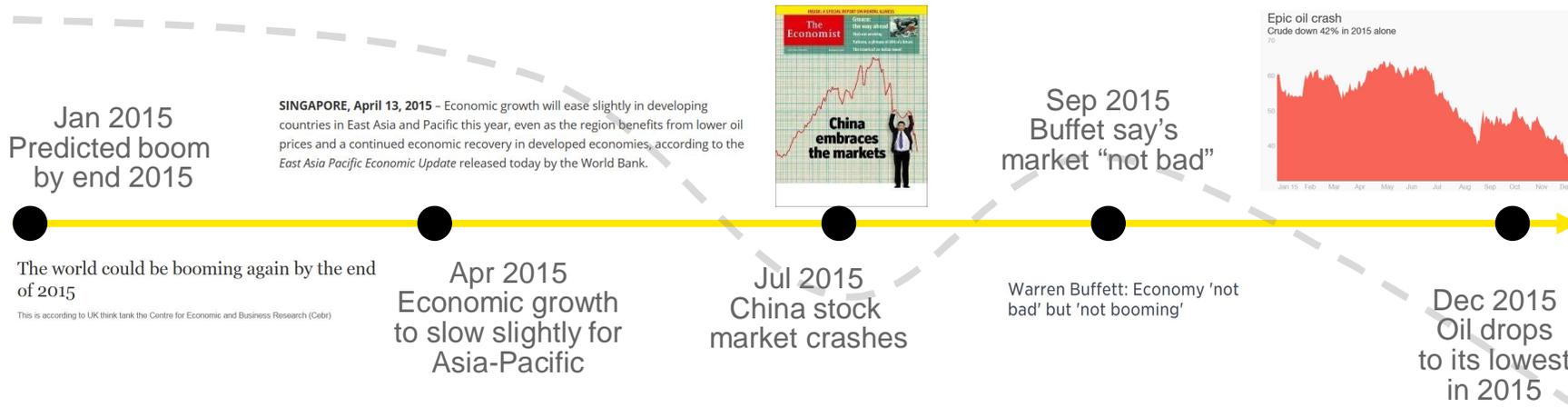


Drivers for change: Macroeconomic uncertainty



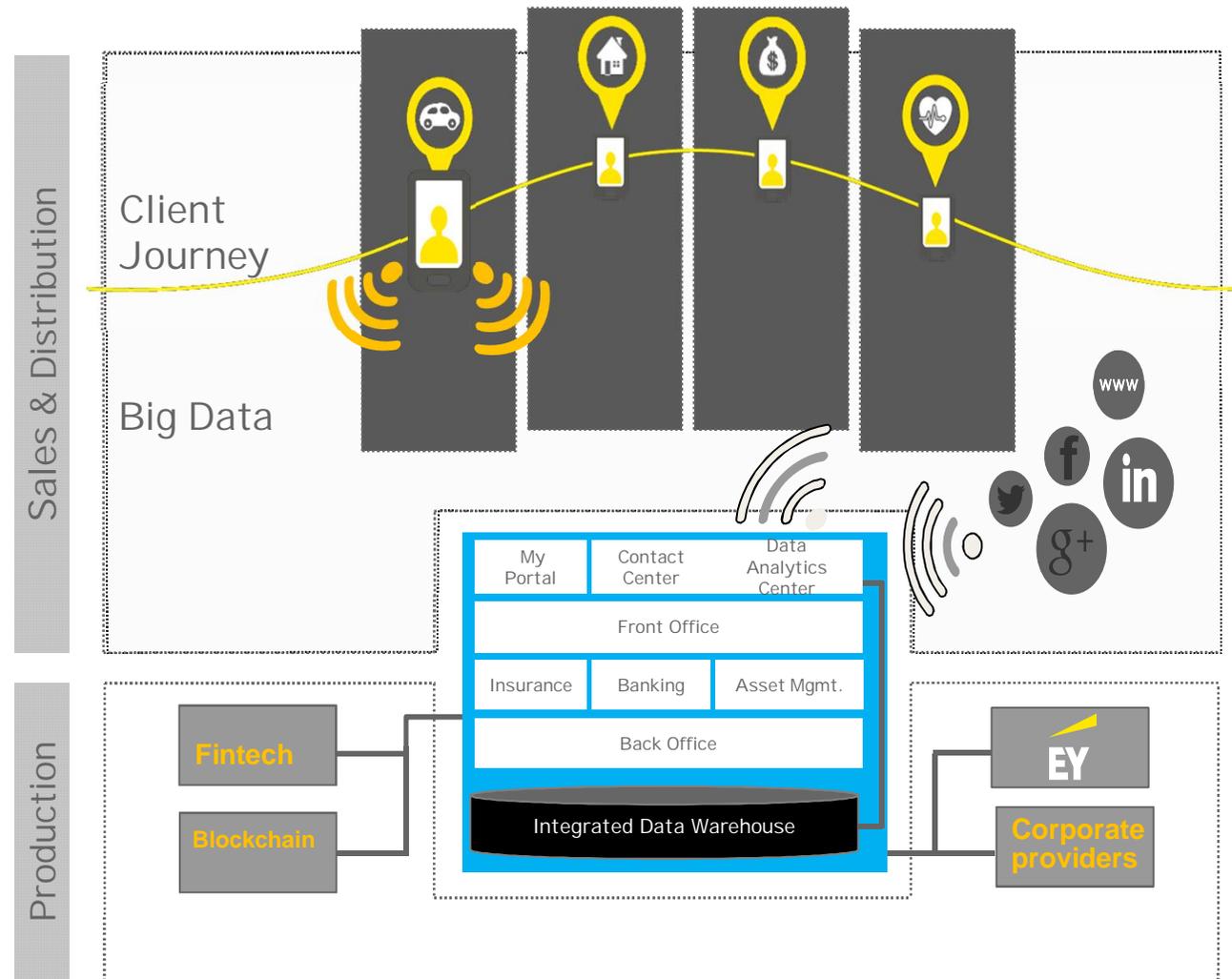
"Volatility in the up direction is not a problem - it's only downward volatility that offers discourse."

Coreen T. Sol

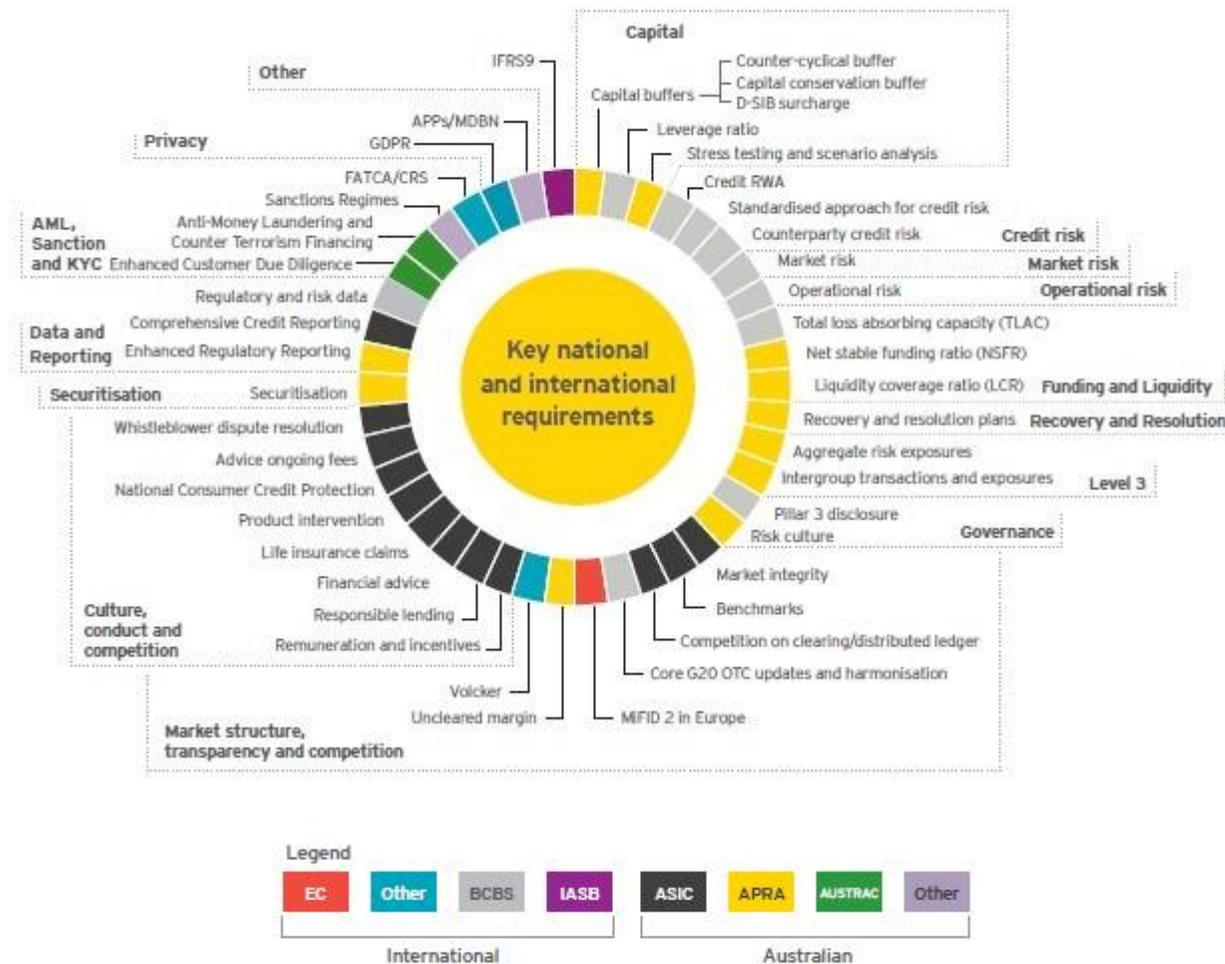


Drivers for change: Changes to business models

- ▶ Digital, Artificial intelligence, Robotic process automation
- ▶ Blockchain
- ▶ Vertical integration
- ▶ Pull based sales/distribution
- ▶ Ecosystem based competition
- ▶ Highly regulated environment
- ▶ Multicurrency based economy
- ▶ Multipolar Market Environment



Drivers for change: Regulatory landscape



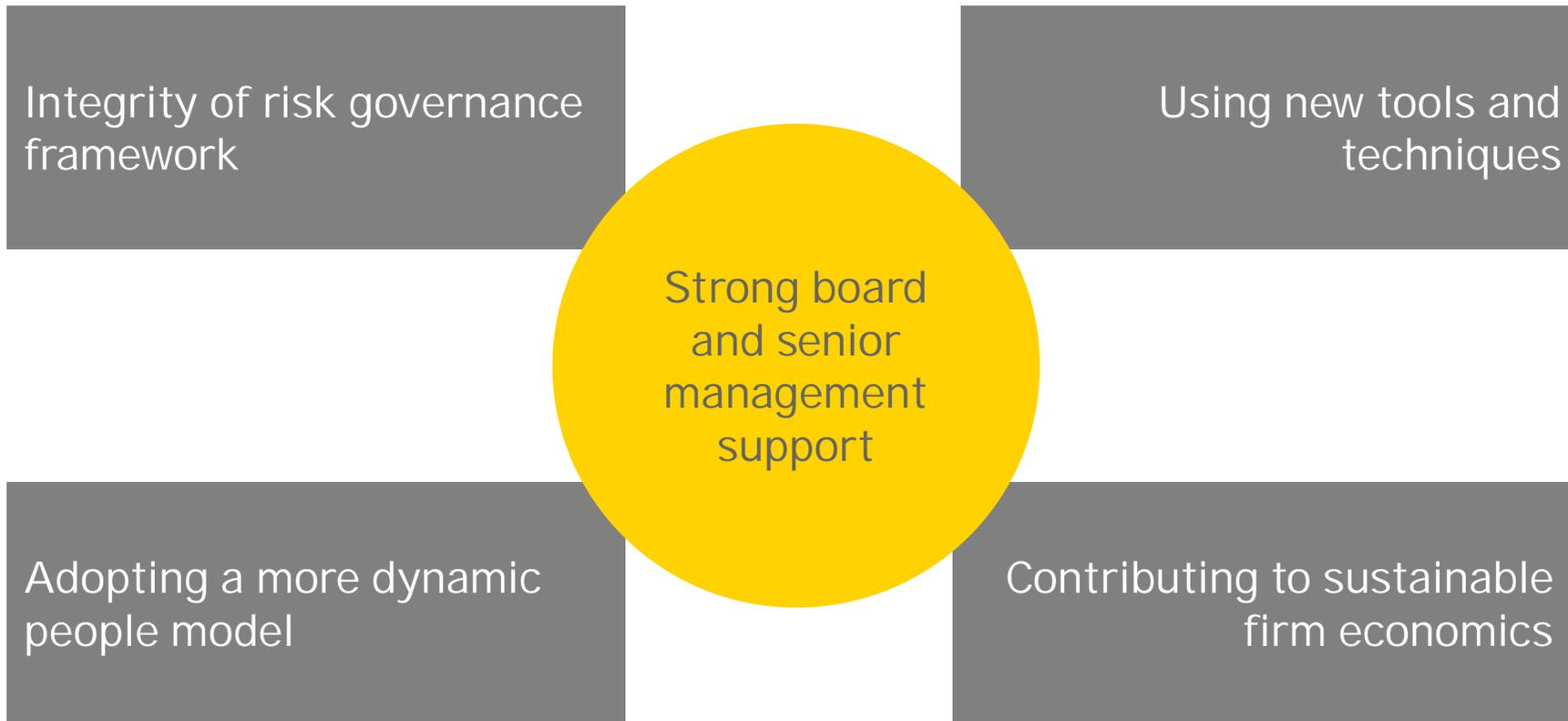
Drivers for change: Stronger governance and culture



Financial services firms are improving risk governance in a number of areas:

- Fully embedded risk appetite frameworks
- Strengthening risk accountability
- Increasing control effectiveness
- Enhancing risk transparency
- Creating an integrated approach to talent and incentives
- Enhancing board oversight
- Fully aligning risk culture with risk appetite
- Enhanced focus on non financial risks.

The four main areas in which internal audit needs to evolve



Integrity of the risk governance framework - 3 Lines of Defence

Function	Business management	Risk management and compliance function(s)	Internal audit
Role	Risk owners	Risk management framework / Review and challenge	Independent assurance
Issues in application	<p>No or limited frontline accountability for risk</p> <ul style="list-style-type: none"> ▶ Significant investments in second-line risk and compliance have confused / undermined frontline accountability ▶ In theory, frontline has responsibility for risks they create; however, in practice, the task has been relegated to the second line ▶ Regulators point to the fact that after most major conduct and control failures, compliance or risk executives get demoted or fired, not frontline leaders 	<p>2nd line has limited scope and insufficient focus on aggregate risks</p> <ul style="list-style-type: none"> ▶ While the second line has grown significantly, it has an insufficient focus on key non-financial risks, notably aggregate compliance, legal and information technology (IT) risks ▶ Second line has not done enough independent analysis of aggregate risks, but has taken frontline information unchallenged, aggregated it, and reported it upward or applied necessary limits; more challenge and independent analysis are required 	<p>3rd line faces significant challenges in scope of coverage and skill set needs</p> <ul style="list-style-type: none"> ▶ Internal audit is affected because of need to broaden its focus equally on financial and nonfinancial risks in the light of individual accountabilities regime (IAR), stress testing, capital planning ▶ Increasingly, internal audit has specific new responsibilities, such as evaluating risk governance framework and risk culture ▶ Internal audit faces a major overhaul in terms of approaches, tools and competencies

Using new methods and tools

- ▶ Purpose - Obtaining an independent view of stakeholder perceptions, identifying areas where internal audit can provide additional value, communicating outcomes to key stakeholders
- ▶ Data analytics - Increase in investment in data analytics and exponential increase in use by IA
- ▶ Risk culture - Build into IA methodology and approach - range of approaches from diagnostic, indicator approach to deep dive with organisational psychologists
- ▶ Productivity and process improvement focus - both across the organisation (how to audit) and within IA function / increase dialogue with the business around recommendations to address findings
- ▶ Innovation - IA functions increasingly focusing on this to increase value/insight provided to the business as well as in response to cost pressures on IA function (automated assurance maps, CCM, integrated audits)
- ▶ Use of technology by IA functions - increasing in areas such as mobile apps, IA specific systems (integrated with other GRC systems)
- ▶ Quality assurance - focussed on outcomes rather than compliance with process. Increasing use of SMEs (including external parties) for QA
- ▶ IA performance monitoring - increasing in sophistication - less about progress against plan etc.
- ▶ Offshoring of IA activity - slow progress but increasing

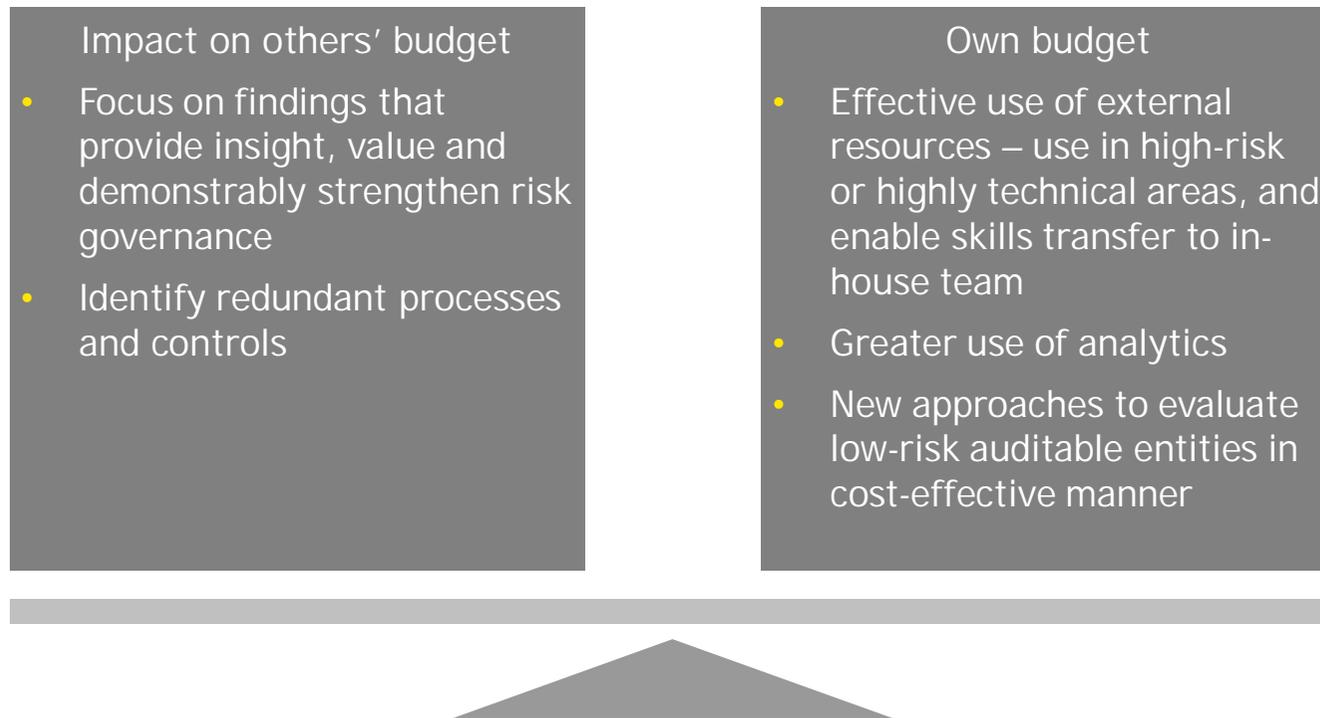
Using new methods and tools (cont'd)

- ▶ Dynamic, flexible annual plans - plans are more focused on the key risks and critical components of the organisation's governance arrangements
- ▶ More flexible and responsive audit methodologies – including embedded assessments of governance, culture, risk management, etc., into every audit
- ▶ Increase in opinion-led thematic reporting on a regular basis - need to have the 'end game' in mind when conducting audit activity
- ▶ Audit activity more focussed on outcomes rather than adherence to process
- ▶ Increase in thematic reviews
- ▶ Audit reports and board reporting becoming shorter, clearer and more focussed
- ▶ More IA functions producing CEO / Executive reports
- ▶ Audit committee being given access to more than just the CAE
- ▶ Increase in board education sessions conducted by IA (and other functions)

Adopting a more dynamic people model

- ▶ Flatter structures allows staff to become more accustomed to interacting with senior executives, non-executive directors and regulators
- ▶ Assess current skills, capabilities, culture, and analysis against target state capabilities
- ▶ Growing specialist knowledge to deliver balanced, but credible, opinions
- ▶ Design and implement learning and development plans aligned to internal audit's strategic objectives

Contributing to sustainable firm economics



Internal audit should be evaluated on the degree to which it has properly assessed and, through its findings, strengthened risk governance and its contribution to firm economics. Ultimately, however, internal audit should not manage itself to a cost-neutral budget.

Board and management support

- Stakeholder support is critical. Board and Audit committee support, from the onset and ongoing, is important, as is support from senior management
- Internal audit senior leadership has to play a key role in championing a new mandate and approach
- Ongoing, clear communications are critical. Everyone especially line-of-business and functional management should understand what changes are planned and be updated on progress
- Being transparent on the intent and approach
- Consider engaging regulators, so they are comfortable with the underlying rationale for change and report on progress

Measures of success

01

Involvement

- Internal audit is involved in all senior management meetings and has access to key decision making forums.
- All levels of internal audit have regular engagement with their relevant business counterparts.
- Internal audit leadership focus their efforts on relationship building, navigating both the organization's formal and informal governance.

02

Impact

- The output from internal audit drives strategic change in the organization.
- Internal audit is able to rapidly adapt to the changing risk profile of the business, providing key insights, not just limited to control failures.
- Stakeholders receive timely updates and opinions from internal audit.
- Internal audit is able to help the business avoid future issues through root-cause analysis, and sharing of knowledge from other business areas.

03

Influence

- Internal audit is sought out by the organization as an independent advisor.
- The function highlights thematic issues across the organization and facilitates best practice knowledge sharing.
- Internal audit opines on all aspects of an organization, including outcomes, culture and the effectiveness of the risk governance framework.

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