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INTERNAL AUDIT'S ROLE IN AN ERA OF REDUCED REGULATIONS

The Trump administration positions itself as pro-business, vowing to clear the path for companies in the United States to operate in a less constrained fashion and enabling marketplace forces to dictate success or failure. A primary plank in this platform is the repeal or revision of certain business-related laws and regulations. While the full scope of the administration's efforts remains unclear, it would seem reasonable that such regulatory reductions could significantly alter the work of internal auditors.

Or would they?

Some expect no great change. They point out that laws and regulations target certain risks that boards and management should address and internal auditors should assess, even with no legal requirement to do so. However, some management consultants are already recommending reductions in internal audit resources in anticipation of deregulation. Such advice is shortsighted.

The issues addressed by regulations — treating employees fairly, respecting the environment, ensuring a safe workplace, fostering transparency with investors and other stakeholders, etc. — help mitigate risk and enable a business to reach its objectives. It is vital for every business to assess whether it is doing them well. For example, the U.S. Sarbanes-Oxley Act Section 404 was written because of the unethical practices of companies such as WorldCom, Tyco, and Enron. Those actions, with their commensurate risk, were real. They happened. And even if Section 404 is repealed, the risk does not go away.

In addition, regulations are subject to marketplace influence. "There are areas where the standard is being set by the market regardless of changes to the regulations," said Scott Rois, board member of The IIA's Environmental, Health & Safety Audit Center. "For example, Dodd Frank 1502, which requires conflict minerals reporting, succeeded in raising social awareness of the humanitarian crisis in central Africa. Even if it is repealed, companies like Apple will continue to demand that their suppliers certify their products as free of conflict minerals."

So revisions to or the repeal of business laws and regulations will not affect the work of internal audit in any significant way? Not so fast.



About The IIA

The Institute of Internal Auditors Inc. (IIA) is a global professional association with more than 190,000 members in more than 170 countries and territories. The IIA serves as the internal audit profession's chief advocate, international standard-setter, and principal researcher and educator.

The IIA

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Change in Focus

With all due respect to Aristotle, nature is not alone in abhorring a vacuum; governments tend to shy from them as well. While some laws and regulations may be reined in or disappear entirely, chances are good others will take their place.



“We expect that, even if the pace of federal rulemaking slows down, states and litigation will take its place,” Rois said.

This shift will result in overall compliance risk at least staying the same and possibly becoming more complex as it becomes more decentralized. This outcome means that auditor expertise will need to be enhanced at the state and local level. Rois further notes that many companies operate in a global economy, which requires them to assess their offshore activities for compliance.

“Even if the U.S. slows down, other countries are still moving forward to implement standards like GHS, the Globally Harmonized System of Classification and Labeling of Chemicals,” he said. “And China is slowly building a regulatory structure like that in the U.S. to address its pervasive pollution.”

Other changes to internal auditing are sure to arise. Market forces, innovation, and the need to serve the public interest will come into play as well. Even if a regulatory slowdown affects conventional audits, new areas will emerge. For example, product stewardship — an environmental management strategy that means whoever designs, produces, sells, or uses a product takes responsibility for minimizing the product's environmental impact throughout its life cycle — is becoming a new focus area. It is one that Rois said he believes internal audit will be challenged to address, given the extremely broad range of expertise required to review all aspects.

While some may paint reduced regulations as a potential windfall, boards and management should consider it as an opportunity to refocus a valuable resource — internal audit — on the risks that are of greatest importance to their organizations. Regulations tend to be “one size fits all.” They are written to address significant, real risks, but those risks do not necessarily threaten all companies.

However, even in enterprises where the targeted risk is low-probability/low-impact, internal auditors are required to devote to it a disproportionate amount of time and resources. Reduced regulations would enable boards and management to work with internal audit to develop a specific, shared understanding of how much attention to pay to which risks.

Rois said he believes that, in an era of reduced regulation, stakeholders would be even more likely to need guidance, not just findings, from internal audit.

“They will not be satisfied with auditors just coming in and telling them what’s wrong,” he said. “They want us to help them understand the root cause and how to fix it.”

A 2015 Crowe Horwath report alluded to the issue of regulatory requirements diverting internal audit’s attention from other areas important to the business.

A reduction in regulations may enable internal auditors to exercise their role as trusted advisor by increasing their focus not only on risk, but also on other areas of the business that are integral to enterprise success.

“. . . Following the passage of the Sarbanes-Oxley Act and other laws and regulations, the focus of internal audit has shifted away from business and operational issues and toward financial controls. To be perceived as valuable business advisors, however, internal audit departments need to overcome challenges related to governance, staffing, operations, and quality and to align their contributions to the organization’s strategic objectives.”

Source: “What Does the Future Hold for Internal Audit?” Crowe Horwath, April 2015

Impact on the Profession

An immediate concern for some internal audit functions in the face of reduced regulation may be an impact on headcount. Many internal audit functions grew to meet regulatory compliance, and now those functions’ CAEs may be worried about losing staff. There is reasonable cause for concern. If staff was added only to address regulatory requirements, they may no longer be needed. Indeed, boards of directors may increasingly ask CAEs to justify the resources they have been given.

This provides organizations an opportunity to better understand internal audit’s value, not just by evaluating its role in assessing risks that were the focus of regulations, but also in ensuring that resources are allocated based on continuing and emerging organizational risks.

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It is not hard to make the case that there is ample risk to keep internal audit fully occupied, regardless of regulatory adjustments. For example, a significant threat in virtually all businesses is reputation — difficult to earn, and difficult to regain if damaged. A weakened reputation can be a death knell for companies, as they struggle to recover credibility and marketplace confidence.

Companies audit their operations to ensure compliance for dual purposes: demonstrating their legitimacy and earning a spot in the marketplace. A regulatory slowdown may change the focus of an audit program, but a comprehensive and robust audit program will always be useful in protecting reputation.

Another driver of risk is change. At the most basic level, a well-designed audit program identifies when change has rendered risk and resources out of alignment. “There will always be change. New mobile technologies, drones, and remote sensing, for example, will change both what data auditors review and how they review it,” Rois said. “But the basic audit objective — a comprehensive and comparable review to define and quantify risk — will remain.”

As plans by the Trump administration coalesce, Richard F. Chambers, CIA, QIAL, CGAP, CCSA, CRMA, president and CEO of The IIA, recommends that internal auditors encourage stakeholders to develop audit plans that are risk-based and flexible, and remain nimble and versatile enough to address changes in the risk landscape quickly and efficiently. For their part, internal auditors should prepare for the future by “communicating honestly and frequently with our stakeholders, constantly examining and updating our processes to remain effective and efficient, and making sure we manage our talent to address evolving risks and serve changing stakeholder needs.”

For further insight into what impact the Trump era might have on the internal audit function, check out Chambers’ blog post, “What Will the Trump Era Mean for Internal Auditors?” at chambersontheprofession.org.



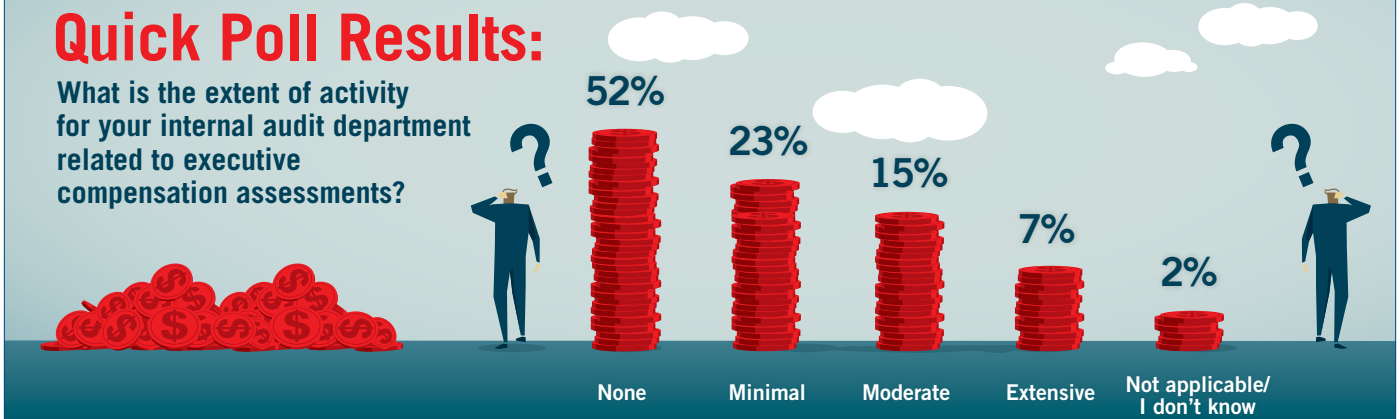
Quick Poll Question

How prepared is your internal audit function to address risks in a deregulated environment?

Visit www.theiia.org/toner to answer the question and learn how others are responding.

Quick Poll Results:

What is the extent of activity for your internal audit department related to executive compensation assessments?



Source: *Tone at the Top* February 2017 survey. Results do not equal 100 due to rounding.