Internal Audit in Focus FY24

An Internal Audit lens to the top risks organisations are facing

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To enable trust and add value, Internal Audit must remain agile and address contemporary risks. KPMG's Internal Audit team have worked through key focus areas for Internal Audit to consider in FY24.

Internal Audit in focus FY24

Macroeconomics

Although the European economy has recovered significantly from the last COVID-related lockdown, the continent is now experiencing a period of negative growth (recession) and inflation. While European and especially Swiss unemployment rates remain low, economic demand is declining considerably. Wage increases (especially in Germany) combined with higher energy and commodity prices and general cost pressures have pushed inflation to its highest level in almost 40 years. Both the European Central Bank (ECB) and the Swiss National Bank (SNB) have responded by raising interest rates steadily over the past 18 months to bring inflation back in line with the target range. The short-term economic outlook is one of a significant slowdown in consumption and investment activity, with declining production and profit margins being squeezed.

From an organisational perspective, it is likely working capital pressures will increase as debtor days blow out and input costs rise. Organisations will need to balance these pressures in an environment of continued strain on global and domestic supply chains, requiring continued management of inventory levels.

Fraud and financial crime are likely to increase as individuals face personal financial pressures.

Internal Audit response

Internal Audit must be attuned to emerging risk and ensure the first and second line continue to evaluate external forces which may impact the organisation. Internal Audit should monitor risks from third party supplier exposures to economic shifts, whilst focusing internally on cost control, working capital management and understanding of debt arrangements.

Internal Auditors should, during every audit, identify potential fraud risks, evaluate the effectiveness of controls that prevent and recognise fraudulent behaviour, as well as conducting targeted data analytics to identify indicators of fraudulent conduct.

Geopolitical

The 2023 edition of the World Economic Forum's (WEF) Global Risks Report coined a new word to describe the situation where a multitude of material problems and difficulties occur simultaneously: a "polycrisis".

The pandemic remains a global threat (including long-term covid effects), as does global climate change and ongoing international conflicts (e.g., the war in Ukraine, Sino-US tensions, the Middle East conflict). Other emerging risks that are becoming more prominent include demographic shifts and the war for talent in the Western world, supply chain disruptions and trade restrictions as well as monetary policy responses to rising inflation and the resulting impact on the cost of living.

Energy markets will continue to be volatile, resulting in government policies to limit energy price increases and competition among countries to capture the value of the clean energy transition.

Internal Audit response

Internal Audit should identify and address potential weaknesses in relation to compliance with international sanctions, as well as assessing how key geopolitical factors may impact an organisation's operation, such as investment decisions, dealings with overseas clients or disruptions to supply chains such as energy, raw materials or technology components.

Internal Audit should support organisations to remain vigilant to geopolitical uncertainties and ensure that organisations understand and have assessed impacts from political, social and economic disruption through scenario analysis, modelling and understanding interdependencies between geopolitical risks and other risks.

Talent has strengthened its grip on the top spot, with 77 percent of leaders nominating it as their biggest challenge in 2023 compared to 69 percent in last year's survey.

KPMG'S KEEPING US UP AT NIGHT 2023

People and talent

Covid has accelerated remote and flexible working, whilst also impacting the free movement of workers, resulting in our highest levels of labour force participation. Whilst uncertainty exists around potential macro-economic impacts associated with a slowdown in consumption and investment activity, including freezes on recruitment and headcount reduction, talent remains a key issue for organisations.

Organisations are grappling with a number of shorter-term people and talent challenges, including:

- **Culture** – the new hybrid model of the workplace and keeping workforces connected, engaged and working to a common purpose.
- **Learning** – the nature of learning and development in a virtual world and the need to adjust traditional learning methods.
- **Return to the office** – balancing the flexibility provided through working from home and the return to the office.
- **Technology** – exposures due to remote working (refer cyber) and upskilling of the workforce to meet a more digitised future.
- **Retention of talent** – remuneration increases have been challenged to keep pace with cost of living increases, increasing risk with regard to retention of existing talent and management of remuneration budgets.
- **Talent acquisition** – unemployment remains low resulting in a continued skills and talent shortage. Organisations are faced with a smaller pool of talent who increasingly demand flexible work, attractive remuneration and personal alignment with the organisation's purpose and social responsibility agenda.
- **Wellbeing and psychosocial obligations** – the impacts of the pandemic on wellbeing and new legislation focused on the management of psychosocial hazards in the workplace. Psychosocial hazards may be event-based (bullying, violence), or could be cumulative (job demands, poor support, low recognition, etc.).

Internal Audit response

Internal Audit has a key role to play in assessing people and talent risks, including:

- strategic workforce planning activities aligned to the organisation's future strategy and workforce needs
- talent attraction, talent retention and succession planning programs
- understanding the impact of employee departures, role vacancies and recruitment freezes on the internal control environment
- readiness for and assessment of psychosocial risks.

Organisational trust

An organisation's trustworthiness and the culture of trust that underpins it are fundamental to its success. Gaining and maintaining the trust of key stakeholders such as employees, customers, investors and regulators is critical, but this is no longer enough. The voices of those in your supply chain or the community in which you operate are also key. It is critical that organisations understand and respond to the sentiment of direct and indirect stakeholder groups.

In recent years, there has been a shift in the mindset of prospective recruits and employees when selecting their employers of choice. No longer is remuneration the key driver of where people choose to work. Rather, factors such as flexibility, workplace culture and the ability to do purposeful work for organisations with strong social values are more prevalent.

Similarly, customers are increasingly making conscious choices about the integrity and credibility of the goods and services they are buying, together with the buying experience. Regulators and investors are seeking evidence of organisational trustworthiness through transparency, integrity and accountability for compliance and related disclosures.

Organisations that fail to articulate and embed a compelling employee value proposition, who are not aware of the preferences of consumers, or who fail to meet compliance and performance expectations, will find themselves battling to retain talent, and maintain brand integrity and market relevance.

Internal Audit response

Internal Audit should consider how governance structures, systems and processes provide accountability and monitoring over the factors that impact organisational trust or published commitments. For example, this may include values or commitments related to taxation and remuneration transparency; local, indigenous and apprentice recruitment; modern slavery and ethical sourcing within the supply chain; progress in achieving ESG targets; or appropriate data collection and storage.

Internal Auditors as part of every audit should question how each process contributes to and exemplifies the organisation's purpose and values.

New Federal Act on Data Protection – nFADP

While technology advancements continue to be central to organizations' growth and efficiency agendas, customers, employees and regulators are increasingly concerned about the protection and use of their personal information. 2022 saw high-profile, significant data breaches resulting in widespread community impacts and increased awareness of vulnerabilities to malicious attacks. Organizations face increased financial penalties for serious or repeated privacy breaches as well as reputational ramifications where privacy, security and data practices are not effective. Organizations must legally and ethically determine what data they collect, what data they retain and for how long, what controls protect it, and what and how decisions are made based on it. In addition, organizations need to assess the impact of the new Federal Act on Data Protection (nFADP) on their data governance and what additional efforts may be required.

Internal Audit response

Internal Audit should assess privacy and data protection controls related to how, why, and what data is collected, stored, secured, retained and disposed of, in line with regulatory and societal expectations. With the rise in algorithmic prediction and AI, Internal Audit must also ask questions regarding how and why the information is being used. Internal Audit should also understand what third party providers have access to or host an organisation's data and the controls which protect its use.

Resilience

The current economic, geopolitical and environmental landscape facing organizations highlights the importance of robust and resilient systems, and the critical workforce which supports it. Events such as the pandemic and international conflicts demonstrate the interconnectedness of risks and the concentration of risk when events occur. Being prepared for disruption is critical to not only surviving disruption but thriving through it.

For example, the effects of and planning for climate change is placing pressure on organizations to adapt and thrive. The strength and frequency of extreme weather events, as seen through significant flooding in spring and the extreme heat in summer throughout southern Europe, generated significant pressures on organizations' systems, creating supply chain disruption and damaging vital infrastructure. Organizations must ensure their operations have planned for and are resilient to these changing weather impacts.

Similarly, the pandemic placed pressure on the resilience, flexibility and skills of workforces to maintain operations safely. Organizations must understand the composition of their critical workforce, what roles and depth of resourcing are needed, what skills are required now and to meet future organizational needs (e.g., digital operators, modern energy skills), and what opportunities exist through automation or the use of contractor arrangements.

Internal Audit response

Internal Audit must be attuned to external forces which may impact the organisation, and understand if an unforeseen event were to occur, how the event would manifest itself. In assessing threats to resilience, it is important that Internal Audit understand what matters most to customers and key stakeholders and bring these various viewpoints together – such as supply chain, cyber security, technology, third party risk, facility management, health and safety, regulatory and business continuity specialists – to ensure all aspects, strategies and resultant impacts are considered. Internal Audit must ensure the organisation understands the impact of potential disruption, what disruption would be intolerable, and the associated cost/benefit of resilience measures.

Regulation

The complexity and pace of regulatory change continues as technology, disruption, ESG and protection of individuals (privacy, consumer finances, psychosocial safety) drive regulatory bodies to respond quickly with new compliance requirements. Regulatory reforms (both proposed and enacted) reflect increasing efforts to enhance organisational resilience and respond to emerging technologies which don't fit within current regulations.

In addition to adapting to regulatory change, organisations must proactively develop – and more importantly maintain – a standard, agile approach to compliance which considers emerging technologies and is scaled across jurisdictions as both their footprint and regulatory expectations grow. Similarly, leading organisations are investing in automation to transform their operations, processes and even business models to drive resilience and agility to regulatory change.

Future regulatory approaches will likely transition from compliance with detailed rulebooks, to an outcomes-based approach focusing on whether the activities are safe and generate benefits for the customer.

Internal Audit response

Organisations need to continuously evolve their compliance efforts to ensure the control environment remains firm in the face of changing regulatory expectations and requirements, risk trends and emerging risks. Evolution in compliance is a necessity even when an organisation's risk profile has remained virtually unchanged.

Internal Audit should ensure the compliance operating model and management systems effectively meets the organisation's compliance obligations, mitigates risks of non-compliance, and can predict and respond quickly to changing regulatory and stakeholder expectations. Internal Audit should support management in identifying opportunities to enhance control activities through automation.

Cyber security

Cyber risks remain a top focus area for organizations. The business landscape is teeming with cyber risks, fueled by an ever-increasing volume of sensitive data moving across interconnected and integrated networks. Recent high-profile cyber incidents have spotlighted the need for secure and resilient systems to protect this sensitive data.

The Swiss National Cyber Security Centre (NCSC) notes in its semi-annual report that 19 048 incidents were reported – an increase of 2 000 compared to the same period last year; these are the cyber risks that can lead to serious regulatory violations, financial consequences and loss of consumer confidence. Organizations need to understand what these risks are and take action to mitigate them. The most common threats are phishing, social engineering and ransomware, leaving data and systems vulnerable.

Internal Audit response

Internal Audit must continue to assess the effectiveness of controls to mitigate cyber security risks. It must ensure that first and second line of defense evaluate and communicate the effectiveness of cyber security controls on an ongoing basis. Additionally, Internal Audit must move beyond traditional framework assessments to assessments of personal behaviors that impact on the organization's ability to protect itself from cyber-attacks.

KPMG's Cyber Security Insights*

48% were less confident in their organisation's ability to subjectively assess cyber risks.

80% felt that AI/ML adoption raises unique cybersecurity challenges that must be prioritised.

75% believe collaborating with extended stakeholders, such as suppliers and customers, is vital to ensuring an organisation's cyber security.

*KPMG Australia's report highlights

Over the next decade, Artificial Intelligence will revolutionize Internal Audit by automating processes and improving audit quality.

Digital disruption

Many organisations are grappling with the risks and opportunities of digital disruption in one way or another.

Technological advancements, such as artificial intelligence (AI), blockchain, cloud computing, and the Internet of Things (IoT), continue to drive digitisation. In customer service, the use of chatbots is providing instant and personalised support to customers through messaging platforms, websites, and mobile apps. The rapid growth of generative AI applications, such as ChatGPT, represent significant business application through the automation of human tasks and processing of complex data. In supply chains, machine learning has transformed the way demand forecasting activities are completed, identifying patterns to predict future demand.

Changing societal attitudes have driven and demanded digitisation. In the workplace, many people have shifted to remote work and virtual interactions. At home, people are using digital devices to conduct everyday tasks including ordering food and interacting with healthcare providers. Organisations have similarly pivoted to new business models through e-commerce, contactless payments and buy now pay later implementation.

Continued focus should remain on data protection, privacy and the ethical use of these emerging technologies within the organisation and increasingly through the extended enterprise of suppliers and business partners.

Internal Audit response

As organisations embrace emerging technologies and new ways of business, the Internal Audit plan must remain agile and adapt to changing business processes. Internal Audit must ensure the risks and ethics associated with these changes have been assessed and appropriate controls and governance implemented.

Internal Auditors need to continuously upskill their technical knowledge to keep pace with the latest trends in technology.

ESG

More countries are moving toward global best practice and society are demanding higher-quality disclosures with evidence of progress towards ESG goals. Mandatory ESG requirements will come into play, as the International Sustainability Standards Board (ISSB) finalise their comprehensive global baseline of Sustainability and Climate Disclosure Standards.

This momentum will require the development of comparable metrics, access to quality data and data management strategies to assist monitoring and measuring ESG delivery promise and performance. COP27 has placed a significant emphasis on prioritising a shift to a decarbonised economy with energy transition at its heart. Organisations must understand the transition risks to achieving their ESG objectives.

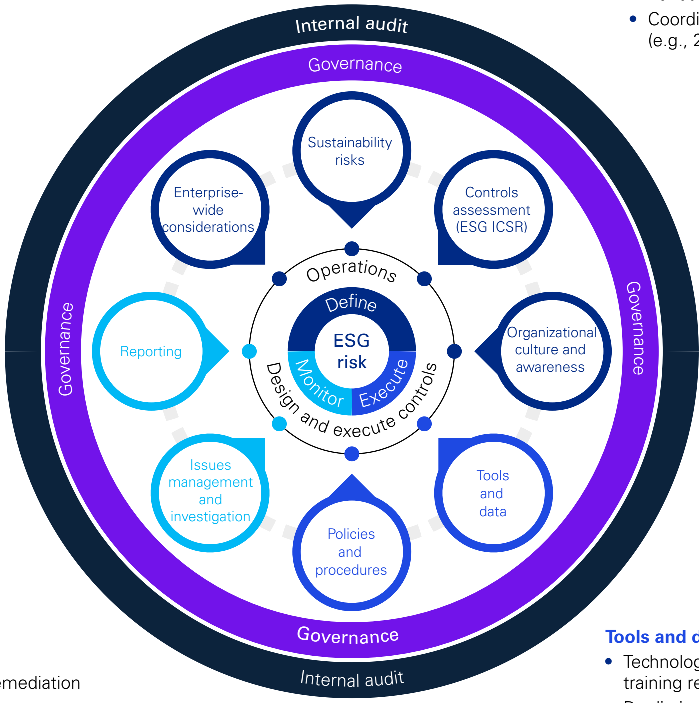
Internal Audit response

Combining the shift toward mandatory reporting requirements and the amount of capital committed to ESG transition, Internal Audit has a key role in supporting organisations to effectively manage ESG risk.

Sustainability risks
- Risk (and opportunity) assessment
- Regulatory requirements
- New product review
- Third-party due diligence

Enterprise-wide considerations
- Definition of ESG
- Mission, vision, values and strategy
- Periodic review by top management
- Context and stakeholder analysis
- Time, resource and budget

Controls assessment
- Monitoring and tracking of regulatory change
- Process and control testing
- Periodic ESG risk program evaluation
- Coordination with other assurance providers (e.g., 2nd line)



Reporting
- Probable regulatory reporting
- Periodic reporting to management and the board
- External reporting to stakeholders
- Record keeping

Organizational culture and awareness
- Engage and create dialogue with all the stakeholders
- Culture/tone of ESG/sustainability and behavioral change
- Regular and frequent training and communication

Issues management and investigation
- Issues/complaints management and remediation
- Responding to regulatory examination/inspection.
- Response plan and process for investigating alleged noncompliance
- Continuous improvement

Tools and data
- Technology to support ESG program (testing, training records, etc.)
- Predictive measures: key risk indicators and key performance indicators
- Root cause analysis and trending
- Data governance/management

Policies and procedures
- ESG policy existence and management
- Entity-wide policies and procedures (human capital, health and safety, cyber, lending and credit practices, investments, etc.).
- Consistency between policy frameworkand strategy

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