

Richard Chambers, President and CEO of the IIA, talks about the future of Internal Audit

Green Internal Audit new concept to support environment and improve organization reputation

Audit Committees between preventing risks and common errors

Highlight on Internal Audit contributions towards achieving company objectives.

Improving Internal Audit Performance through Strategic Planning



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From The President



Dear Readers,

We are now under 50 days to inaugurating the International Conference 2018. The hectic pace towards sponsorship and registrations is picking up. We certainly look forward to meeting you at the venue and the one of a kind event which will be held in the Middle East for the first time and unlikely to return at least for the next 6-7 years. The networking opportunity will be immense and there will be a lot to learn. I urge you not to miss this golden opportunity.

We have also recently released the Success Stories of the winners of the 2017 Best Practice Award. This award deserves a special mention as some of the success stories will be presented in the International Conference 2018 and should give a huge boost to our regional organizations in putting forward their success in front of the world.

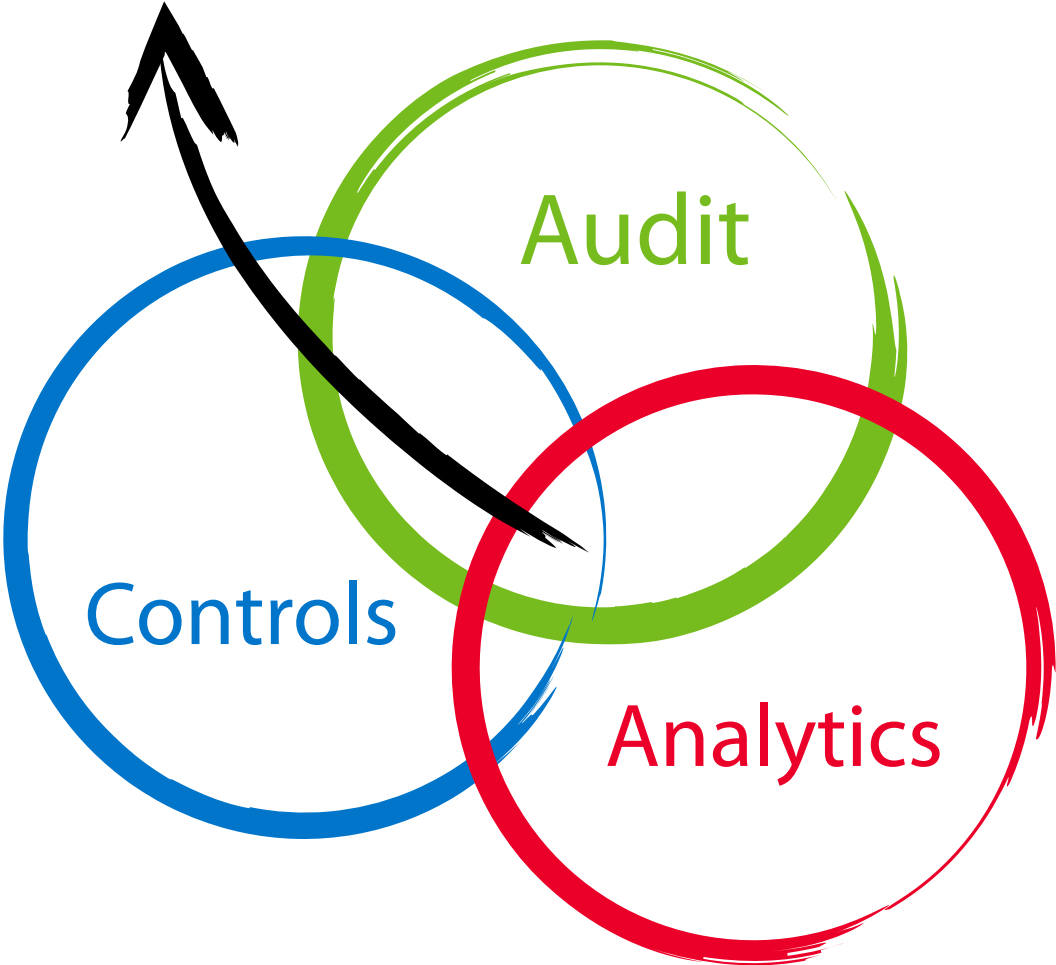
I also urge our fellow auditors to take advantage of the CIA training session to be held during the conference and avail the insights of one of the worlds leading trainers for CIA. The COSO certificate course is also offered by the UAE IAA which has been highly successful and found to be valuable by the attendees.

Regards,

Abdulqader Obaid Ali
President

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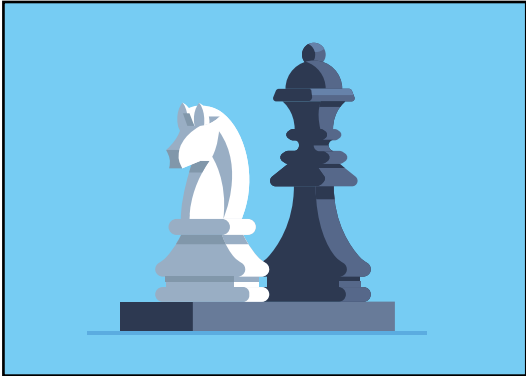
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Reader Feedback

We want your views on the articles and the magazine! Share your thoughts and feedback with us via email at ghada@iiauae.org

Comment on an article entitled (Challenges Facing Internal Auditing in the Future).

I thank colleague Sami Abu Zina for this wonderful article that goes to the point, as internal audit professionals should understand what drastic and rapid changes in business structures and their implication on the way of constructing an internal audit plan and on changing internal audit programs and supporting internal audit service with competency and expertise that can handle such challenges .

Some financial and non-financial institutions started introducing robots to carry out work in such a way that an error rate has become almost non-existent and productivity at very high levels without the presence or intervention of a human being.

Traditional control concept has changed, for instance, there is no compiler or certified auditor for the financial process prior to implementing and forwarding to the accounting system. The robot carries out the whole business from A to Z. The internal auditor cannot describe that the financial process has no dual control factor.

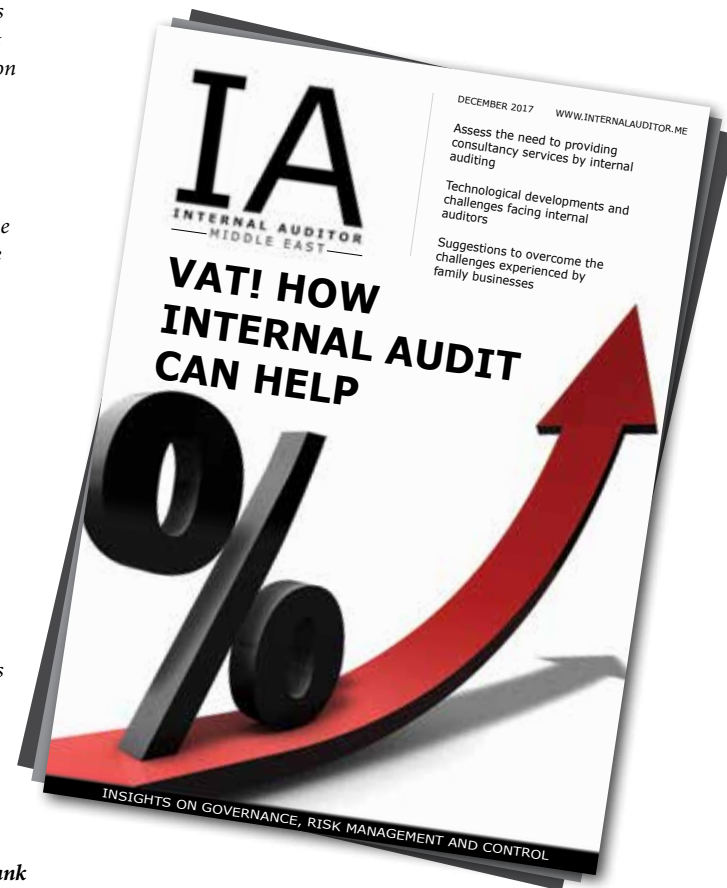
We have the concept of electronic government led by the client, in such a way that a service is requested with an application filled up, electronically. Electronic systems, according to their programmed mode, perform the service without interference of a government employee and fee payment is done electronically, too.

With all these lightning speed changes in, the internal auditor can only accept change and cope with it; otherwise the profession and its workers are at risk.

AlSharif Marwan AlKholi

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Dubai World Trade Center

By: Vishal Thakkar

Executive perspectives on Top Risks 2018

Not too long ago, top risks for C-suite executives were regulatory scrutiny and economic conditions as against today their top issues include disruptive innovation, digitalization, organizational resistance to change, cyber threats and corporate culture.

Key findings of the survey of board members and C-suite executives

Based on the survey response, the overall global business context is less risky in 2018 relative to the two prior years, with respondents across the globe sensing a slight reduction in the scale and severity of risks in 2018 related to 2017.

Respondents indicated that

they are probable to allocate additional time or resources to risk identification and management over the next 12 months.

While respondents indicated slightly less concern about the overall scale and severity or risks for 2018 relative to the two prior years, there are noticeable shifts in what constitutes the top 10 risks for 2018 relative to last year. Overall Top 5 risks highlighted are as follows:

1. Increased speed of disruptive innovation
2. Resistance to change



3. Managing cyber threats
4. Regulatory change and increased regulatory scrutiny
5. Culture may not encourage timely escalation of risk issues

<https://www.protiviti.com/US-en/insights/protiviti-top-risks-survey>

Characteristics of Financial Restatements and Frauds

Corporate reporting quality has been at the most important place of the profession since the major corporate accounting scandals such as Enron and WorldCom at the beginning of the century. Analysis of various characteristics of financial statement restatements and frauds discovered from 2000 to 2014 which demonstrated how financial restatements and frauds have been affected by shifts in the regulatory and economic environment. The analysis set out how financial reporting quality (i.e., the deterrence and detection of restatements or frauds) has been affected by trends in restatement and fraud from 2000 to 2014.

Frequency of Financial Statement Restatements versus Frauds

The statistics appear to support the view that with the passage of SOX in 2002 and the implementation of SOX section 404 in late 2004, led to increased restatements.

Categories of Financial Statement Restatements versus Frauds

For financial restatements, the most common reporting issue related to debt and equity accounts or quasi-debt/equity instruments with conversion options (21% of restatements on average) as this category ranked first in 11 of the 15 years.

Characteristics of Companies with Financial Restatements and Frauds

Companies with restatements were smaller than those with frauds in terms of total assets and market capitalization.

Magnitude of Financial Restatements and Frauds

The number of companies with restatements that had an identifiable impact on earnings increased in the post-SOX era but fluctuated greatly. The number of restatements and frauds has decreased, however, the dollar amounts of losses continue to remain significant.

Analysis of Study Results

1. Increased and improved governance practices under SOX and the enforcement of SOX section 404 may be associated with the increased discovery of financial misstatements resulting in increased number of restatements and frauds
2. Whilst most major causes for frauds did not vary with shifts in corporate reporting and regulations, significant causes for restatements arose due to changing accounting guidance, the unraveling of industry-wide improper accounting practices, the macroeconomic climate, or heightened regulatory scrutiny
3. At least 50% of the financial misstatement cases are by relatively small companies (market capitalization of less than \$250 million), suggesting that smaller companies are of higher risk of financial misstatement
4. The median percentage of spending on non-audit services has declined in the post-SOX period, and the relative investment in non-audit versus audit services has fallen to 15% over time

<https://www.cpajournal.com/2017/11/20/characteristics-financial-restatements-frauds/>

Cyber Risk Management Using the Three Lines of Defense Model

Cybersecurity risk should also be managed like any other risk across the three lines of defense i.e. ownership, oversight and assurance.

The Three Lines of Defense for Cyber Risk Management

1. Management Control

The first line include the information security department and other business units that own their cyber risks. This is often called as management control as this function is responsible for managing cyber risks by executing various controls.

2. Risk Management

The second line of defense consist of risk managers who

look at risks at an enterprise level. This function monitors how management (first line) is handling cyber risks by determining the extent that risks are actively monitored and appropriately managed.

3. Internal Audit

The third line of defense is internal audit and may include input from external auditors and/or regulators as well. The third line can challenge the assertions of the previous lines regarding the adequacy of the controls in place.

<https://securityintelligence.com/take-a-load-off-delegate-cyber-risk-management-using-the-three-lines-of-defense-model/>

7 Factors for Internal Audit's Role in Artificial Intelligence

Whether we recognize or not, Artificial intelligence (AI) has arrived in our lives. Many of us experience AI on a daily basis through our interactions with virtual assistants such as Siri, Alexa, Cortana, or Google, and organizations are increasingly incorporating the advances that AI brings into operations. The question to ponder: 'is internal audit prepared to provide assurance over the complex algorithms this technology relies on to facilitate organizational success?'

Internal audit can provide value to organizations by applying its skills toward understanding the organization's objectives with AI and ensuring that risks are being addressed. Set out below are seven critical areas internal audit

needs to prepare for:

1. AI Governance
2. Data Quality
3. Human Factor
4. Measuring Performance
5. Reemphasize Cybersecurity
6. Filling the Understanding Gap
7. Ethical Issues with AI

https://iaonline.theiia.org/blogs/Jim-Pelletier/2017/Pages/7-Factors-for-Internal-Audit's-Role-in-Artificial-Intelligence.aspx?utm_source=SilverpopMailing&utm_medium=email&utm_campaign=20170464_TheStandard_Profession_120517%20%281%29&utm_content=&spMailingID=17879267&spUserID=MTEwNTM1NzA5NDgwSO&spJobID=1123044105&spReportID=MTEyMzA0NDewNQ52



Pulling fraud out of the shadows

49%

of global organizations say they've experienced economic crime in the past two years

52%

Of frauds were committed by insiders

68%

of external perpetrators, responsible for 40% of fraud are frenemies of the organisation – agents, shared service providers, vendors and customers

24%

frauds committed by senior management increased from 16%

Types of Fraud

Asset Misappropriation

45%

Cybercrime

31%

Fraud committed by consumer

29%

<https://www.pwc.com/gx/en/services/advisory/forensics/economic-crime-survey.html>

By: Samia Al Yousuf

The seventh Chief Audit Executive conferences - Dubai

Under the patronage of His Excellency Eng. Sultan bin Saeed Al Mansoori, Minister of Economy, UAE

UAE Internal Auditors Association held its 7th CAE conference at Rixos Premium, Dubai on 12-13 December.

Mr. Richard Chambers – IIA Global CEO was the keynote speaker during the concluded Conference themed “Internal Audit in the matrix of digital world”. During the conference Mr. Richard had book signing for his newly released book “Trusted Advisors”

H.E. Dr. Saeed K. Al Dhaheri Chairman of the board, Smartworld the conference guest speaker had presentation titled ‘Auditing in the area of artificial intelligence ‘

The third Best Practice Awards in Internal Audit for private and government sector was presented during the. The awards were divided into 3 categories; Governance, Risks and Controls, IT and Fraud. The winners were judged on the criteria of Innovation, Successfully Structured Implementation and Benefits for the Department the Organization.

In preparation for 2018 International Conference UAE IAA organized press conference to announce and marketing for the conference.



UAE IAA and Protiviti host a Joint Session with Bob Hirth on Emerging Risks for Business on February 2018

UAE Internal Auditors Association (IAA) in association with Protiviti Member Firm for the Middle East Region organized a joint session with Bob Hirth, Immediate Past COSO Chair & Senior Managing Director of Protiviti, on the theme of ‘Emerging Risks for Business in 2018 and the New COSO Enterprise Risk Management (ERM) Framework’ in Dubai and Abu Dhabi.



UAE IAA held an awareness session on Internal Audit for governments entity

As part of its role in advocacy and promotion internal audit profession, the UAE IAA organized a seminar on the importance of internal auditing and its role in achieving companies’ objectives to non-auditors from various departments in the Federal National Council in Abu Dhabi

The session was covered by Hisham Al-Tohami, Associate Director – Business Risk Services

Grant Thornton - Abu Dhabi, UAE



UAE IAA and RAK Finance Department held a session Marketing 2018 International conference

UAE IAA and RAK finance department held an awernace session at Hilton Ras Al Khaimah as a part of marketing the 2018 international conference that will be held for the first time in the MENA region under the patronage of H.H. Sheikh Mohamed Bin Rashid Al Maktoum Vice president and Prime Minister of UAE and Ruler of Dubai.



By: Arif Zaman

CLOUD COMPUTING

INTRODUCTION

The world is moving from onsite to offsite computing and storage, which is commonly known as cloud computing. The question arises: 'What is cloud?' Cloud is just a metaphor for the internet.

In a survey conducted by GT (Grand Thornton LLP, 2014), 43% of Chief Audit Executives (CAEs) responded that they haven't really given much thought to risk and control implications in a cloud environment.

In the simplest terms, cloud computing means storing and accessing data and programs over the internet, rather than storing it onsite in your own data centre.

The table below shows key differences between onsite and offsite computing.

Current Onsite Computing	Future Offsite Cloud Computing
Applications, services, devices	Services
License based	Subscription based
Capital expense	Operating expense
Modules	Applications
Operate, maintain, upgrade, trouble shoot, fix	Use
Build, install, power, cooling data center	Use
Capacity building	Entitlement
Pay for the capacity installed as a fixed cost	Pay for capacity as a variable cost

BENEFITS OF CLOUD COMPUTING

Benefits of cloud computing include:

- 'Pay as you use', as it can be relatively easy scale up or down capability for your work requirements.
- Services are provided over the internet, therefore are accessible anywhere and anytime.
- Additional capacity and functionality can be acquired as required.
- Company capital can be saved on ICT infrastructure, as this is provided by the cloud service provider.

CAE Survey on Cloud Computing

In a recent Grant Thornton survey, more than 300 CAEs responded on cloud computing, with the key statistics being:

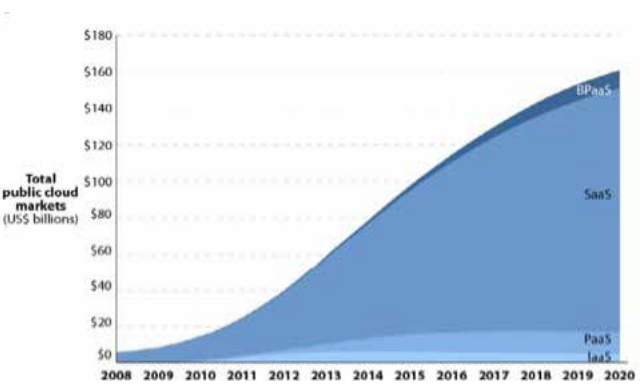
- 77% are at least somewhat familiar with cloud computing.
- 64% of respondents do not include cloud computing in their internal audit plan.

- When asked to describe their view of risk and control implications in moving to a cloud environment, 43% responded: "I haven't really given it much thought".

CLOUD COMPUTING MODELS

- **Software as a Service (SaaS)** – Software applications delivered over the internet.
- **Platform as a Service (PaaS)** – Full or partial operating system and development environment delivered over the internet.
- **Infrastructure as a Service (IaaS)** – Computer infrastructure delivered over the internet.
- **Business Process as a Service (BPaaS)** – A form of business process outsourcing that employs a cloud computing service model.

Cloud computing is growing, as the following graph shows:



KEY CLOUD COMPUTING RISKS

1. Security

Risks:

- Service provider data security standards may not match company requirements.
- System updates may not be timely.
- Security vulnerability assessments or penetration tests may not be regularly performed.

2. Multi-Tenancy

Risks:

- Company data may be accessed by third-parties.
- There may be inadequate encryption to assure data is properly segregated at rest and during transit.
- Company data on shared server space may lead to regulatory non-compliance.

TO COMMENT on the article,
EMAIL the author at arifzaman786@yahoo.com

3. Data Location

Risks:

- The company may be unaware of the physical or virtual data storage location.
- Service provider may change the location without informing the company.
- Company data may be stored in international locations that fall under foreign business or national laws and regulations.

4. Service Outage

Risks:

- Service provider quality standards may not be in line with company requirements.
- Cloud system performance issues may lead to company services being inaccessible to employees or customers.

5. Sustainability

Risks:

- The service provider may go out of business.
- The company may not be able to retrieve data, or a third-party may gain access to company data.

6. Scalability

Risks:

- The service provider may not be able to scale to meet the company's growth requirements.

ASSURANCE STRATEGIES

- Use your own contract and not the service provider contract.
- The contract with the service provider needs to include conditions that cover these risks.
- Insist on receiving the service provider risk assessments.
- Include penalties in the contract for service provider outages, non-delivery and under-performance.
- Require the service provider to meet your data security and other requirements.
- Determine whether service provider security posture is based on appropriate standards such ISO, PCI DSS (Risk Assessment Special Interest Group (SIG) and PCI Security Standards Council, 2012), etc, and the service provider performs regular security assessments.



- Determine the service provider Service Organization Control (SOC) (AICPA, n.d.) report addresses your company's control requirements.
- Review the service provider methodology used to access data.
- Insist on a copy of the service provider business continuity arrangements, and reports from tests performed.
- Make sure the company business continuity plan is up-to-date and regularly tested.

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Arif Zaman, FCCA, CIA, CISA, CPA, CFE,
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By: Farah Araj

Richard Chambers

The President and CEO of The Institute of Internal Auditors shares his thoughts on the future of internal auditing

In addition to his IIA role, Richard serves on the Committee of Sponsoring Organizations of the Treadway Commission (COSO) Board of Directors and the International Integrated Reporting Council (IIRC).

Finally, Richard has authored two award-winning books: *Trusted Advisors: Key Attributes of Outstanding Internal Auditors*, which was released in early 2017; and *Lessons Learned on the Audit Trail*, which is currently available in five languages.

Internal Auditor Middle East connected with Richard Chambers during his most recent trip to the United Arab Emirates.



How has the internal auditing profession changed over the past 5 years?

I think there have been some quite positive trends. Regulators, boards, and other stakeholders are increasingly seeing the value a strong internal audit function can bring. And, possibly as a result of this enhanced appreciation, resources devoted to internal auditing have shown a steady climb. There is every reason to feel good about the trajectory of the profession, but, of course, to maintain that favorable status, we have to continue delivering value, anticipating rather than merely reacting to stakeholder expectations.

What are the new trends influencing Internal audit? E.g. artificial intelligence and robotics?

Like any profession, internal audit is subject to the changing demands and opportunities brought by technology. We need to expand our expertise in fields such as cybersecurity, artificial intelligence (AI), data analysis algorithms, and data privacy — all of which are now in our purview due to technology.

But technology is just one facet of a larger topic: business disruption. Our research indicates that the coming years will be characterized by significant disruption in business models, markets, and strategies. This is likely to place increasing pressure on boards and executive management to address more complex and rapidly escalating issues in the workplace. Internal audit must position itself to be part of the solution.

We believe internal auditors should help their organizations deal with disruption by keeping a laser focus on the things they historically do well: assurance, risk management, controls, and governance. They should also engage with subject matter experts and enhance their own skills to keep a finger on the pulse of emerging technologies and pursue the necessary technology-relevant training.

How much of the changes to our profession can be attributed to changing stakeholder expectations?

Given some of the recent misdeeds by companies around the world, it is reasonable to expect that stakeholders will look to internal audit to provide strong assessments of operations. However, I do not think this is solely a stakeholder-driven development. Internal auditors, as a profession, have been proactive in encouraging attention to the issue, both directly and indirectly — directly, by advocating for the benefits of better systems and controls (and internal audit's role in assuring them, of course) and indirectly, by delivering performance that proves our point.

**“More than ever, Middle Eastern businesses need trusted advisors who embrace disruption as an opportunity rather than a setback”
— Richard Chambers**

So what will internal audit look like in the next 5 years?

I think there will be some major shifts in focus. For example, I believe there will be less emphasis on internal controls and more on how well management is managing risks. This is likely to be accompanied by a reduced focus on auditing traditional financial reporting and transaction areas

(such as accounts payable) and more attention paid to areas representing strategic organizational risks. As internal auditors increasingly rely on technology to improve audit efficiency and effectiveness, and we embrace a more diverse talent and skill mix into our ranks, I believe we will be perceived less as “the police” and more as trusted advisors supplying valuable assurance and advisory services.

Do you believe your view of the future of internal audit is relevant to the Middle East region?

Absolutely. No part of the world is an island unto itself, and the same pressures affecting organizations outside the Middle East are being felt in the Middle East as well, as your companies become increasingly engaged in global business. This global engagement means that what happens to internal audit around the world will also affect internal audit functions in the Middle East.

Given where the profession is heading, what should an internal audit department's 2020 strategy include?

Based on my previous comments, it is probably not a surprise that I would recommend leveraging technology aggressively. It is not a “badge of honor” to use old technology. Be future-focused; for example, learn how advanced analytics embedded in cognitive computing (often considered AI) can be used to improve internal audit. Doing so may necessitate my second recommendation: broadening the skill sets in internal audit by looking beyond just accounting and finance personnel. Remember that technology expertise and soft skills are also needed in internal audit. And, finally, do not shy away from the difficult areas to audit, especially technology (e.g., blockchain), culture, and strategic initiatives. Auditing accounts payable is important, but limiting internal audit to only that sort of work is a sure path to irrelevance.



How important will it be to become a trusted advisor in the future?

As long as our organizations need internal audit to help them — and I see no end to that — it will be important for internal auditors to be trusted advisors. Organizations currently face issues such as culture and strategy that are enormously impactful and require skills that go beyond the services provided by a traditional compliance auditor. Trusted advisors can bring to these issues a high level of skill and finesse, coupled with a business acumen born of an in-depth knowledge of the organization's challenges, operations, risks, and market opportunities. It is hard to imagine that organizations will ever decide these contributions are anything other than critical.

Will conformance to the IIA Standards remain relevant?

The research says yes. Our recent survey on the internal audit common

body of knowledge indicates that, of the half of the stakeholders who know of the Standards, 94 percent say conformance brings value. I doubt that stakeholders will ever come to believe it is a good idea to have an internal audit function that is ignorant of and/or nonconforming with the standards of the profession. Based on that, I believe that CAEs should assume that conformance will soon be an imperative, if it is not already.

Any final advice to CAEs on how they can remain relevant over the next 5 years?

Internal audit is facing some significant challenges, many of which I have mentioned in my comments. Heads of audit can create the changes that will enable the profession to meet those challenges, but they cannot do so by using traditional approaches. Internal audit must ramp up its agility and innovation.

Some of our recent research shows that the majority of audit executives agree with the need to become more agile and innovative, but unless they start to address that now, they leave the profession vulnerable to being left behind. They cannot afford to wait until it is “safe” to change or the “time is right.” No one is expecting them to see into the future. But they do need to understand what is going on in the business and in their own departments and be willing to challenge the status quo. Not everyone can be a leader, but they can become fast followers in adopting new mindsets, advanced technology, flexible processes, and a staffing model that searches diverse backgrounds to find candidates who can think analytically, communicate well, and understand the business.



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By: Farah Araj and Robert Kuling

Improving Internal Audit Performance through Strategic Planning



Developing a strategic internal audit plan not only improves internal audit’s alignment to business objectives, it also ensures that the internal audit department remains relevant.

Introduction

If you were doing an audit of an organization’s governance processes or an audit of a subsidiary and discovered that their strategic planning process had significant gaps or was none existent, would this be an observation in your internal audit report? It most certainly

would. Yet internal audit departments themselves don’t always have a strategic plan, let alone a good strategic plan.

Although strategic planning is not part of the IIA’s International Professional Practices Framework’s mandatory guidance, it is part of recommended guidance. It is one of the ways to address the IIA Core Principle “Aligns with the strategies, objectives, and risks of the organization.” Without a strategic plan it is difficult to demonstrate the internal audit department’s alignment to the organization’s strategic plans and how they are helping the organization achieve its

objectives (as defined by the organization’s strategy). A strategy forms the roadmap for the internal audit department’s mandate, people, processes and technology. This roadmap is what ensures that the internal audit department remain relevant.

A Glimpse at the Current State of Internal Audit Strategic Planning

Take a moment and Google “strategic internal audit plan example”. What you’ll get is a mixture of guidance from the IIA and others, examples of internal audit strategic plans, and naturally, irrelevant results. What is surprising at this day and age is the number of examples of strategic

plans which have no vision, mission or actual strategy. They are simply the output of an annual internal audit plan that has been mapped across a 3 or 5 year period. What this means is that some internal audit departments do not exercise proper strategic planning. The latest data from the IIA’s global internal audit survey¹ supports this conclusion:

- Only 55% of internal audit departments are fully aligned or almost fully aligned with the strategic plan of their organization (this drops to 42% for the South Asia/India region).
- Only 52% of Chief Audit Executives (CAEs) indicated that they have a separate written mission statement for their internal audit department.
- Only 36% of CAEs stated that they have an internal audit strategy description.

When analyzing the results above, one wonders how 55% CAEs can be fully or almost fully aligned with the strategic plan of the organization when only 36% of them have established an internal audit strategy.

An internal audit strategic plan is not a series of audits over a 3 to 5 year period!

Understanding Organizational Strategy

Before going into how to develop an internal audit strategic plan, we should take a step back and look at organizational strategy. Simply put, a strategy is a plan put in place to achieve a long term objective. It is “big picture” thinking which gives an organization a sense of direction. It helps to focus and prioritize an organization’s

resources on particular goals since organizations can’t do everything all at once!

An organizational strategy usually answers 5 questions which correspond to 5 major elements of a strategic plan as shown in table 1 below.

Strategic planning at an organizational level usually takes place annually, although the specific objectives/strategies may or may not change depending on how well they are going as an organization.

So would internal audit strategic planning be any different from the above? Absolutely not!

The organizational strategic plan also impacts internal audit activities (both strategic and operational). Here are 3 examples:

1. **Risks to Strategic Objectives:** The IIA Standards require internal audit departments to address risks to strategic objectives. A percentage of the internal audit plan along with specific audits would need to be identified and addressed and as part of the annual internal audit risk assessment and planning methodology.
2. **New Organizational Priorities:** The organization may have set in motion plans to expand to new countries/ regions, to get into new business lines (or exit current business lines), have plans to implement new systems, etc. Internal audit needs to ensure that it is ready to support the business through these organizational priorities and gear up to have the resources to audit risks in these new areas.
3. **Organization Wide Initiatives:** There are organization wide initiatives that impact all departments

including internal audit. This could be cost cutting, diversity/gender empowerment, virtual offices etc.

All these elements, and more, would need to be addressed by the internal audit department in the long term and as part of the internal audit strategic plan.

Developing the Internal Audit Strategic Plan – In Brief

The process (which is more of an annual cycle) to develop an internal audit strategic plan is largely based on the same process followed at an organizational level. Although CAEs may approach strategic planning in a different way, a proposed process is illustrated in Exhibit A.

The starting point for any internal audit strategic plan is about understanding the expectations of the key stakeholders: the audit committee, the CEO and senior management. These **expectations differ from one company to another** and could include expectations such as focus on cost recoveries, assurance on key business processes, supporting fraud risk management, being a source of talent for management etc. There may be multiple views from stakeholders and CAEs would need to prioritize them into “non-negotiable” vs. “good to have” expectations. Understanding expectations is not a one off exercise; this should be done regularly and preferably annually.

What comes next is the understanding of the current state of the internal audit department. This could take the form of an analysis of mandate, people, process and technology or take the form of a SWOT analysis. This analysis is the core of any strategic plan. It will determine what your department needs to fix and what is capable of **realistically** achieving; you’ll need to walk before you start running!

Question	Strategic Plan Element
1. Where are we now?	Current State Assessment
2. Where are we going?	Vision/Mission
3. How are we going to get there?	Objectives, Initiatives, Activities
4. How will we know if we got there?	Targets/Key Performance Indicators
5. How did we do?	Performance Reporting

Table 1



Exhibit A

Then based on stakeholder expectations, the current state analysis, and taking into account the organization's strategy as noted above, as well as developments in the internal audit profession, the CAE will work to develop a vision of what the internal audit department will look like in the next 3 to 5 years. The vision is a **concise, forward-looking** narrative that provides a **high-level** strategic direction for internal auditing. This vision defines where we want to go to. The nature of the vision would also depend on the maturity of the internal audit function (identified as part of the current state assessment). A maturing internal audit department vision could be related to conformance with the IIA Standards. While a mature internal audit department could strive to be "the leading internal audit department among its peers."

Subsequently, the CAE can now identify the gaps between the current state and the

future vision and develop objectives and initiatives to address the gap. While the number of objectives and corresponding initiatives can be endless, one needs to keep in mind the total amount of time that would be allocated to these initiatives. These initiatives would ultimately feed into the annual internal audit plan as shown in Exhibit B.

The amount of time and resources allocated to initiatives would depend on the importance of the initiative to the internal audit department and organization. Initiatives would be spread out over a 3 – 5 year horizon; i.e. not every initiative would be completed in year one. It is also important to assign measurable targets to each initiative; otherwise it would be difficult to demonstrate progress and/or completion.

Finally, the strategic plan would be presented to senior management for

feedback and subsequently to the audit committee for approval. The strategic plan would then be implemented by the internal audit department and performance against the strategic plan would be measured and reported on a periodic basis. By demonstrating that internal audit is aligning to the organization and its department's vision, internal audit show progress in its internal processes and the value it brings to helping the organization achieve its objectives.

Also remember that the internal audit strategic plan is a living document that would be updated at least on an annual basis, similar to the approach followed by organizations.

A Few Tips

- Engage your team – let them support you in developing the vision and supporting objectives and initiatives.

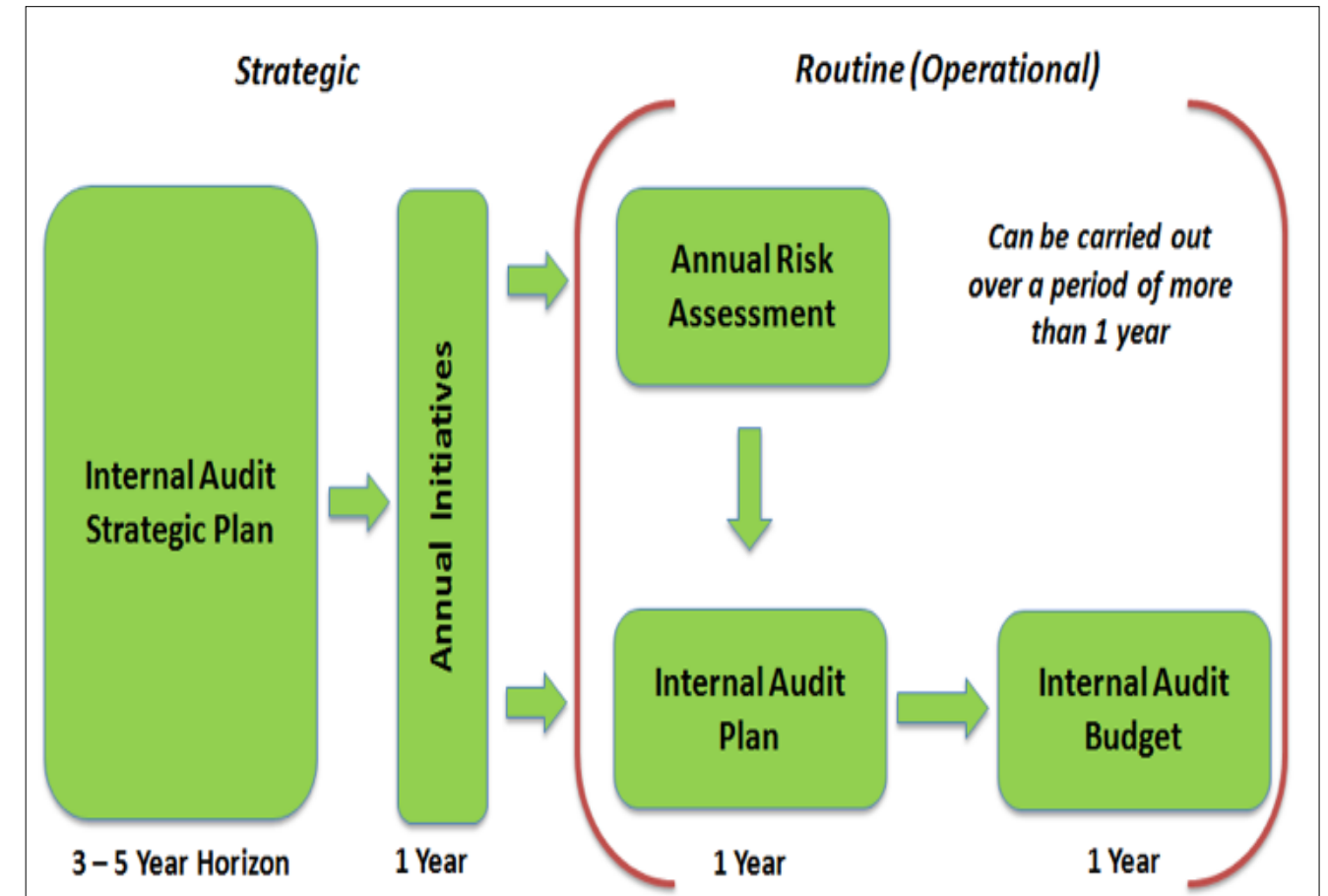


Exhibit B

- Focus on realistic goals and targets; don't "bite off more than you can chew".
- Link individual performance goals to the achievement of strategic objectives / initiatives where applicable. Hold them accountable for delivering on these initiatives.
- Communicate with stakeholders and the IA team and keep them up to date on any success and/or challenges to implementing the strategy.
- Course correct where you need to - where an initiative is not practical or where you have underestimated the cost to complete, don't be afraid to call this out and adjust; the organization does the same!

Conclusion

Developing an internal audit strategic plan is part art and part science. While a structured approach may be followed, it is the CAE's capabilities that play a big

part in determining the quality of the final output. Research from the IIA² emphasises strategic thinking as one of the key skills needed to becoming a CAE. This strategic thinking will give the CAE a better view of the organization's future and how the internal audit department should fit into that future.

While this article proposes a brief approach and overview of strategic planning for internal audit, there may be different approaches that CAEs may choose to follow to develop a strategic plan. Regardless of the approach that is chosen, there should be a future state that addresses the organization's strategy and the expectations of key stakeholders. Without such a plan in place, the internal audit department may lose focus in the long term.

Lastly, the internal audit department will not be able to survive on an annual plan alone. This will result in a reactive approach to organizational changes and stakeholder requirements as opposed

to planning for them and anticipating them. It's time to look ahead and think about what is to come and show your key stakeholders that you are evolving and preparing for the future!

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Disclaimer: Opinions expressed in this article belong solely to the authors, and do not necessarily represent the views of the IIA or their employer. This article was originally published in the IIA India Quarterly, Vol 3

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BY: Ayman Abdel Rahim

Green Internal Audit

“Green” is a description of all that is concerned with protecting the environment and supporting sustainable development. This description has been used to show that organizations are concerned with environment and support sustainable development. They also adopt goals, policies and action procedures to achieve that. Examples of using “Green” description include green marketing, green technology, green economy, green buildings, green cars, green bonds, green chemistry and green knowledge. In this article, I would like to be the first to initiate a new term into this long list, which is “Green Internal Audit”

Green Internal Audit?

After this brief introduction, the definition of green internal audit will not be beyond the traditional scope of internal audit where internal auditors play a role in strengthening the green character of the organization they work for, as they are not involved in direct initiatives in this area. Green internal audit is “to provide assurance on the effectiveness of practices adopted by organization to support the environment and sustainable development in order to add value to the organization and improve its reputation.”

Pay Attention to Earth Planet

Earth, the planet in which we live, needs care and attention to ensure a suitable life environment for future generations. News releases from the United Nations News Center on Environment and Climate indicate that some governments care about the environment, climate and sustainable development. In contrast, the News Center also points at many facts that show increase in environmental pollution where pollution has spread to the atmosphere, oceans, rivers, land and air that we breathe. One



of these facts is the increase in carbon dioxide emissions (CO2) of around 50 per cent since 1990 and the acceleration of emissions growth between 2000 and 2010, to more than any of the previous three decades.

By 2050, it is likely, at least one person in four, would be living in a country that suffers from chronic or recurring shortages of fresh water.

If the world's population reaches 9.6 billion by 2050, almost three times the size of the planet may be needed to provide natural resources in order to sustain current lifestyles. Such facts require setting up of sustainable development initiatives by organizations to ensure their continuity. A simple example illustrating such importance: a fishing company can increase its profit by catching as many fish as possible; forgetting such fishing activity would lead to extinction of fish. Hence, it

must have some initiatives to protect those fish from extinction and increase their reproduction to ensure a continuous profit.

The same applies to paper manufacturing companies that rely on trees to produce paper.

Sustainable Development Goals

In 2016, the Organization for Sustainable Development has set 17 goals for sustainable development to transform our world into a better one. Those include ensuring sustainable consumption patterns and production, taking urgent action to address climate change and its impacts, establishing a sustainable infrastructure that is able to withstand, stimulating inclusive and sustainable industrialization and promoting innovation.

Many of the sustainable development goals are applied at government level, but various organizations contribute and have a major role in achieving those goals. The achievement of those goals requires applying the simplest rules of management, i.e. to promote efficiency in use of resources, energy and innovation in work and to search for solutions that reduce cost, also search for Initiatives for business

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sustainability. Those goals are not binding for governments and organizations, but rather could be guidance and may open the door to consider the importance of protecting and preserving environment. Translating such goals into action would be achieved by imposing laws and guidelines that are binding for organizations to protect the environment and maintain sustainable development

Green Internal Audit is “to provide assurance on the effectiveness of practices adopted by an organization to support the environment and sustainable development in order to add value to the organization and improve its reputation.”

Corporate Governance and Social Responsibility

Corporate governance practices call for corporate ethical commitment as well as social commitment, environmental support and sustainable development. In a my previous article titled “Corporate Governance, Ethics and Leadership,” I mentioned that the King's four report has brought about fundamental changes, most notably, governance of ethics, importance of evaluating soft controls, and considering that the organization is part of the society and sustainability of development as one of the factors to develop performance. The principles of corporate governance have become a social dimension where organizations must have a long-term view of positive results for society and environment through improving their resources and developing skills of workers.

Social responsibility, on the other hand, is one of the components of any effective governance system. Such social responsibility consists of three pillars: environment, society and economy. For example, environment focuses on reducing carbon footprint, waste and water consumption, while society focuses on community and stakeholder support, and economy focuses on sustainability of profit. In addition, under the economy pillar comes having compliance, risk management and effective governance, while this pillar can't be considered alone in isolation without taking into considerations the other pillars as they complement it and have future positive impact.

Role of Internal Audit

Internal audit should be instrumental in activating organizational corporate governance practices related to sustainability and social responsibility. It is an opportunity for internal audit to add value by maintaining the organization's reputation and walking away from traditional auditing while showing to senior management the importance of maintaining the organization's reputation and business sustainability at the same time.

Internal audit's interest in this regard begins by including risks related to environment and sustainable development within the risks assessed for setting up the audit plan. It may be important to include an audit within the annual plan, which may include audit programs within its scope to cover, some aspects of sustainable development individually.

Moreover, it is important to assess adequacy of initiatives undertaken by our organization in this area. Keeping in mind that this requires developing auditors' knowledge in this area to meet stakeholders' expectations and add value to the organization we work for.

In addition to this, the consulting role of internal audit is the largest one, as it should assess the extent and impact of an organization's efforts in that scope. The consulting role also lies in advising on the importance of having both a clear strategy and policy in this regard.

Organization goals should include a goal related to supporting the environment and sustainable development. This goal should include the three pillars, environment, society and economy;

It can also highlight the importance of adopting relevant initiatives, indicators and performance measures related to this. In addition, it is necessary to demonstrate the importance of adopting organization practices in a way that helps achieve those goals, for instance, the organization may impose some contract terms to suppliers, contractors and service providers, to ensure commitment to sustainable development goals. Internal audit may recommended to adopt comprehensive periodic reports on compliance with relevant standards and legislation related to

this goal, benchmark comparisons of environmental practices such as practices of environmental impact reduction, reduced energy consumption, emitted pollution, packaging waste percentage, increasing recyclable products, increasing the use of technical systems and reducing paper use.

In the end, it is our duty towards the planet “Earth” we have to fulfill so as to ensure a decent life for our children and future generations.

Green Internal Audit is an opportunity for each internal auditor to demonstrate his/her professionalism through non-traditional auditing, adding value and achieving what is expected from us as internal auditors. Finally, we must achieve the requirements of internal audit principles by having a forward-looking vision as sustainable development goals call for a better future for humankind.

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Audit Committee

By: Alaa Abu Nabaa

Edited By: Raymon Helaly

The Most Common Mistakes in Audit Committees' Work

The existence of an audit committee is one of the main characteristics of implementing the rules of good governance, as this committee establishes a culture of commitment and accountability within any organization, regardless of the nature of its activity or size, by providing reasonable assurance about the efficiency and effectiveness of internal control systems and risk management applied in organization, in addition, to ensure the independence and integrity of external auditor.

In this sense, the general assemblies of shareholders or boards of directors of organizations (according to the best governance practices) form audit committees, emanating from within, that are consistent with the nature of organization activities, in terms of number of members or expertise and skills, to be provided by their members. Therefore, many corporate governance codes around the world have sought to regulate the role of audit committee to improve its effectiveness as it is considered the most important control committee emanating from the board of directors or from the general assembly of shareholders.

Audit committees should play a preventive role in the control system and risk management and ensure that attention is paid toward control mechanisms and policies that prevent financial and operational disasters. However, there are some mistakes made by these committees, which adversely affect their ability to complete this important role.

Thus, the following are some of the most common mistakes that I have compiled through my direct contact with many audit committees in a number of Arab countries and through talking with several colleagues in the profession:

First: Mistakes in the committee formation and its relationship with other committees of the board:

The right formation of audit committee is the most important factor in determining its effectiveness. One of the most common mistakes in forming a committee is having an executive board member or other executive or even chairman of board of directors in the committee, or not to consider the independent member



as complementary to the non-executive members of the committee in terms of expertise, knowledge and skills.

It is important that all members have good knowledge of governance, its regulations and requirements, and adequate understanding of the nature of organization activity, provided that at least one member is fully aware of accounting requirements related to organization activity and impact of such nature on financial statements. To address this issue, some central banks have imposed, on financial institutions, having a member of audit committee with knowledge and experience in financial sector. Moreover, financial markets around the world have imposed on joint stock companies to have one of their members to be knowledgeable and expert in accounting and auditing, both the internal and/or external ones.

It is also a common mistake to think that post graduates in accounting are suitable for committee membership, even if they do not have any practical experience. In my view, professional experience and its resulting knowledge in internal, external auditing and accounting is different from theoretical knowledge.

In addition, there is a lack of coordination

between the audit committee work and the rest of control committees under board of directors or general assembly of shareholders, such as risk management committee, compliance and governance committee, and others, and not approving committee charter by the board or general assembly of shareholders, or not reviewing and updating it periodically.

Second: Mistakes in the relationship between the committee and executive management:

A good relationship between audit committee and executive management is important for both parties. One of the mistakes that may affect the organizational relationship between them is that the committee never ask executive management about internal audit observations that have not been resolved or about implementing its accompanying recommendations. Moreover, the committee does not deal objectively with executive management comments on internal audit activity, by following attitude of "that's out of our scope" and shirking responsibilities.

Third: Mistakes in the committee relationship with internal audit activity and with internal audit director:

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Common mistakes in this context include:

- 1) Lack of awareness among the members of the committee that they are responsible for the effectiveness and efficiency of internal audit activity.
- 2) Lack of assuring that the internal audit plans are in line with organization strategies and covering the most important risks encountered, and lack of assuring effective coordination between the internal audit activities and the rest of internal control departments within organization (risk management, compliance management, security management and safety management, etc.).
- 3) Lack of knowledge about the methodology followed by the internal audit activity and not asking the director of internal audit department in a critical manner about achievements of internal audit activity.
- 4) Failure to promote importance of having an independent audit activity in organization, for both board of directors and executive management.
- 5) Non-approval of a charter, policies and procedures of internal audit department.
- 6) Failure to have a meeting with director of internal audit department without having a representative of executive management.
- 7) Failure to look at and approve a strategic plan (not annual plan) of internal audit activity.
- 8) Allow executive management to intervene in appointing the director of internal audit, determining his remuneration, not to review and approve annual budget of internal audit activity and leave it to executive management and not to ask the director of internal audit department frankly about his personal assessment of the level of his independence from executive management and its level of cooperation with him.
- 9) Failure to carry out a periodic assessment for internal audit activity by the committee (at least once a year) and by an external party (at least once 3-5 years).
- 10) Rely, mainly, on director of internal audit to perform duties and responsibilities of the committee.
- 11) Weak interaction of the committee with the results of internal audit reports, or failure to take appropriate

action against those who do not respond to internal audit reports despite ongoing follow-ups from internal audit department; which may lead to frustration among internal audit team and weakening the role of internal audit activity in organization.

Fourth: Mistakes in the relationship of audit committee with external auditor:

Common mistakes in the relationship of audit committee with external auditor:

- 1) Failure to have a meeting with independent auditor, periodically, to discuss a proposed work plan, and ensure his/her independence and objectivity. Or not meeting with him/her unless there is a representative of executive management in presence, and not auditing financial statements critically. We rarely find an audit committee that seriously discusses auditor's opinion, work followed in covering some important audit elements such as investments, debt allocations and performing some important tests. It is worthwhile noting here that the independence of auditor may be affected if he/she has submitted consulting work to organization and/or if executive management has solicited offers and negotiated fees with the auditors.
- 2) Not asking external auditor to submit to management (Management Letter Points) and study his/her notes about corporation financial statements and on the adequacy of internal control systems and on follow up actions.
- 3) Lack of knowledge about the requirements of adopting international standards, and with possible weaknesses and manipulation and leaving the matter entirely to executive management and the auditor.

Fifth: Mistakes in committee meetings:

Some common mistakes in relation to committee meetings include low number of meetings, short duration, poor preparation by its members, failure to read internal audit reports presented to them, lack of documenting all the matters that were discussed in committee minutes of meetings, but, documenting only the decisions and recommendations, and delays in preparing the minutes or approving it. In addition, it is wrong to believe that documenting some sensitive issues may harm organization reputation, and also not reporting, periodically, on committee work to board of directors or general assembly of shareholders.

Sixth: Other mistakes:

- 1) Leaving the process of request for proposals and fees negotiation in relation to outsourcing some or whole of internal audit activities to executive management.
- 2) Failure to follow up the latest laws and legislations issued concerning organization activities.
- 3) Failure to follow up and carry out periodic review on effectiveness and efficiency of managing the most important risks facing organization, whether strategic, operational, financial or compliance.
- 4) Lack of focus on information security and IT risks.
- 5) Failure to adopt any mechanism that allows all organization employees to provide their comments secretly about any violation of regulations, and not to verify effectiveness of implementing such mechanism, by conducting an independent investigation commensurate with the size of error or override and not adopting appropriate follow-up procedures.
- 6) The committee never exploits its authority to review organization records and documents, to ask for clarification or statement from members of board or members of executive management, and to ask board to call general assembly of shareholders for a meeting if board obstructs its duty.

The role of audit committees is of continuous development and their focus on old means considering the developments in the risk environment and the enormous size of task on shoulder of board of directors is no longer sufficient. Therefore, they should focus more on organizational changes that may affect overall control, risk management processes, compliance with regulations and laws, and on helping the board to play its supervisory and control role over executive management performance, thereby supporting independence of external auditor and increasing effectiveness of internal audit activity and internal control systems.

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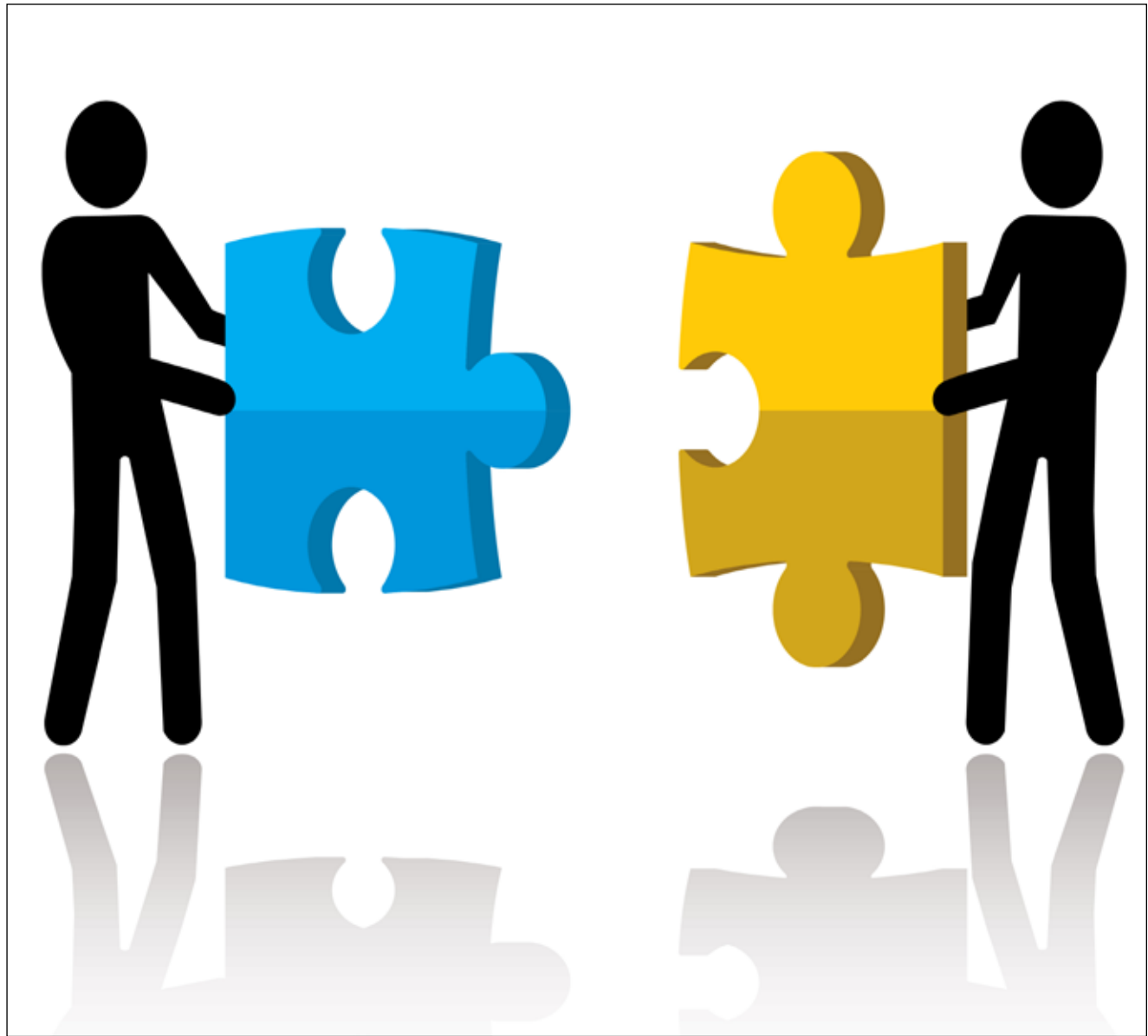
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By: Lalit Dua

Recognizing Internal Audit Contributions



IA professionals have been advocating and proclaiming value additions by IA for decades. However, periodic reminders are required for management and other stakeholders regarding the same. The IA

processes, approach, techniques and styles have undergone change over a period of time and even definition of IA has changed. The changes were pertinent to keep pace with changing business scenarios and

IA professionals have indeed done this alignment with splendor. This article is an attempt to highlight contributions of IA towards company objectives. The article will attempt to cover

IA contributions to different departments/ processes of a company, especially a manufacturing company. The detail of value additions highlighted here below is not exhaustive and much more can be written about it.

The contributions included here are the ones as per my experience while working with diversified business groups in India and abroad.

1. Human Resource

Though some of the activities of this function are not to be audited because of confidentiality of personal data such as pay package and benefits to employees, however there are many areas which can be subject to audit. These are -

- Organization charts of each department and its updating with increase/decrease of employees and change of position and roles,
- recruitment as per approved manpower budget; and documentation and updating of career growth plans and availability of the same with each function head and employee are important to be reviewed and will add value.

The HR documents a training calendar every year but many a time fails to adhere to the same. A timely review of its documentation, based on requests received from functional heads after annual performance reviews, and non-adherence will highlight to the management areas which need timely action.

The following are some of other important areas where the reviews will add great value. These are -

- Documentation and updating of operating manuals, HR policies and their adherence
- Review of engaging contract labor and verification of wage bills as per terms of agreement

- Review of processes for recording of attendance, its updating and review by HR staff concerned
- Compilation and verification of all required data needed for Payroll processing like loss of pay, deductions of different accounts, change in salary details etc.
- Verification of returns, statements and other relevant documents to ensure statutory compliance

2. Sales and Marketing

Though the working of this department is very dynamic and policies and guidelines change frequently according to marketing requirement, still IA can play a pivotal role to not only keep a check on misuse of policies but also make pertinent recommendations.

IA can highlight inappropriate activities and approaches of marketing the products/ services like putting a hoarding of a high end premium product at low income group housing societies or doing roadshows of FMCG products on weekdays. The biggest setback a company can have when extensive marketing activities have been done but products are not available for sale in required quantities. IA can even proactively highlight this scenario to management based on projected sale vs. available stock.

IA can contribute significantly by doing concurrent audit of correct applicability of discounts and other incentives, timely updating of changes in commercial policies in the system, fixation of prices considering budgeted margin, change in taxes etc. The sales team is always under pressure to meet its periodic targets. The worst situation for a company can be when discounts and incentives are being provided at a predicted time like last week of the month. The customer will wait and book his order only during that period. I

In one case I reported to the MD of a company that a 250 gram product is being packed in 500gram packing under sales team pressure, since 250 gram packing was not in stock. This minor deviation, according to sales team, could have affected brand value of the product as well questions could have been raised on good governance.

3. Procurement

The activities and processes of this department have always been subject to high risk of fraud. This could start from the process of determining quantities to be procured. IA can subject the following critical areas to regular audits-Maintaining required number of approved vendors for A and B category products and seeking quotations from these vendors only. The exceptions are to be approved by higher authority.

1. Adherence to approved authority matrix for approval of PO and amendments to any terms, including quantity
2. Verifying rating of vendors as per approved criteria and guidelines and taking required action as per policy
3. Closure of POs in the system against which quantities to be delivered are pending but not executed for long. Such open POs can be used for fraud..

The effectiveness of procurement processes can contribute significantly in reducing cost of production and enhance profitability and IA can ensure this.

4. Quality Assurance and Controls

The QA and QC department not only ensure that processes are followed but also ensure that the output is as per defined quality standards.

IA can play a role by verifying that all QA & QC SOPs are updated, documented quality parameters are being reviewed as defined, approved vendor facilities are being audited as planned and no vendor can be included in approved list without QA approval, and calibration of testing tools and equipment is done as scheduled.

Even though QA department defines its own annual audit plan but many such areas where financial and accounting aspects are concerned, they can be further audited by IA. Such areas can include identification of expired stock or near to expiry, frequent receipt of substandard products received from approved vendor, mismatch of quality parameters of products given to vendor and the ones with QC etc.

5. Plant Maintenance

At first sight it appears that IA cannot provide value in an area which is more technical then procedural, but the truth is that there is rarely any activity and process which cannot be subject to audit. The effective maintenance of plant can ensure meeting of production targets which will ultimately result in substantial saving in product cost.

IA can verify maintenance of machine history card, maintenance of inventory of critical engineering parts, adherence of preventive maintenance schedule, effective and optimum utilization of engineering tools and machines etc. IA can also do analysis of high expenses being incurred on maintenance of a machine which may be due to substandard parts being used or correct processes not being followed for preventive maintenance. The Engineering department is responsible for quality of services rendered by outside service providers for engineering parts and IA can review whether the same is being ensured by it by conducting quality check and testing the items before being used on production floor.

6. Production planning and Productivity

Production planning plays a significant role in meeting the forecast and it is subject to continuous monitoring, reviews and amendments. IA will have to understand the intricacy of the various assumptions, facts and data while reviewing its processes. The production planning is done quarterly, monthly, weekly and even on daily basis. IA can review whether production planning is being done based on forecast/actual requirements and the same is provided to Procurement department for material planning. IA can also review optimum utilization of production capacity by rationalizing batch size of products. The engagement of workforce, permanent and contract, is also part of production planning and the same should be accurately done to keep a check on labor cost.

7. Resource Optimisation

In a manufacturing company there are ancillary facilities and utilities which are integral part of production operations. The effectiveness with which such utilities are used will add to production effectiveness. Such utilities include boilers, DG sets, Cooling systems etc. IA can on a periodic basis verify whether preventive maintenance has been done as planned, inventory of critical parts is maintained, consumption of fuel and output is as per standard. Also, IA can verify that all statutory compliance is done for these utilities and required certificates are displayed at appropriate places. Even review of records of capacity utilization, with reference to production capacity utilized can highlight under/over utilization of utilities and the same has its own implications.

8. Warehousing

The end products after completion of all processes, hard work of direct and indirect workforce and spending of all stakeholders' money is finally stored in warehouse. Hence it's very important that functioning of Warehouse is always as per standard. IA can verify that the storage conditions are as per product requirements and are subject to continuous monitoring. The controls on checking un-authorized access, storing of products on defined locations, proper maintenance and handling of warehouse equipment are some of the areas which can be reviewed by IA periodically. Further, working of all fire extinguishing equipment and alarms should also be reviewed.


Conclusion

The list of areas where IA can do value additions includes many more important areas and including all those in one such article is not possible. IA can support other important areas like effectiveness of ERM framework, financial and accounting areas, statutory, Taxation and strategic compliance etc.

Because of its unique position in the organization, IA function can play multiple roles in every aspect of its working be it compliance verification, investigation, reviewer, advisor and facilitator. The IA function is required to be given a status and appropriate authority to carry out its function effectively. The CIA is also required to be self-motivated, analytical, always up to date about the business and its processes and capable of making objective assessment.

Finally if management consider and in reality establish IA function as an important support, IA can effectively align its activities with business activities and provide much needed support.

Lalit Dua EVP- Internal Audit and Risk Management with Riskpro India Ventures Pvt. Ltd.



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Is your internal audit activity in full conformance with the IPPF (The Standards)?

Has your internal audit activity conducted a Quality Assessment?

UAE IAA offers the following Quality Assurance Services

Readiness Review

- Conduct an independent gap analysis focused on the internal audit activity's current level of conformance with the Standards;
- Recommend actions for remediation of identified gaps to the IPPF.
- Identify opportunities to improve efficiency and effectiveness of IA processes

Self Assessment with Independent Validation (SAIV)

- Self-assessment by the internal audit activity
- Independent validation conducted by UAE-IAA team


External Quality Assessment

- Assess how well the IA activities conform to the International Standards for the Professional Practice of Internal Auditing (Standards)
- Evaluate the performance of the IA department and substantiates the expectations of the board and executive management
- Identify opportunities to improve efficiency and effectiveness of IA processes

Advantages of Quality Assessments

- ✔ Raise awareness of IA professional standards amongst management
- ✔ Identify areas for improvement
- ✔ Full conformance with the IIA Standards
- ✔ Bring systematic, disciplines internal audit approach
- ✔ Increase credibility within the organization
- ✔ Anticipate, meet or exceed stakeholders expectations
- ✔ Benchmark IA practices

UAE IAA Quality Assessment



By: Islam Al-Rayes Edited By: Ayman Abdlerahim

Corporate Governance ... Company Life Cycle



Corporate governance is an integrated culture and work approach which is not simply an adherence to a set of rules and can not to be interpreted narrowly and literally.

Corporate governance is a culture that must stem from the company itself and commensurate with it. For each stage of company life cycle, a governance system must exist to help the company in meeting its objectives and to develop and grow, hence, effective governance ensures the achievement of the results.

The definition of corporate governance is not restricted to mature companies only; it is defined as “a group of foundations and principles governing the relationship between the owners of companies and all

other stakeholders, in order to achieve company objectives and preserve rights of all stakeholders.”

Governance evolves as company grows

Companies and organizations are always looking for the best and working hard to enhance their competitiveness and aspire to continuity in a complex and rapidly changing business environment. This environment is often characterized by emergence of new risks and legislations enacted recently that must be committed to. The corporate governance system must be developed to be in line with company needs. As governance begins at organization establishment and develops gradually with its development - at different stages - in a way that allows it to

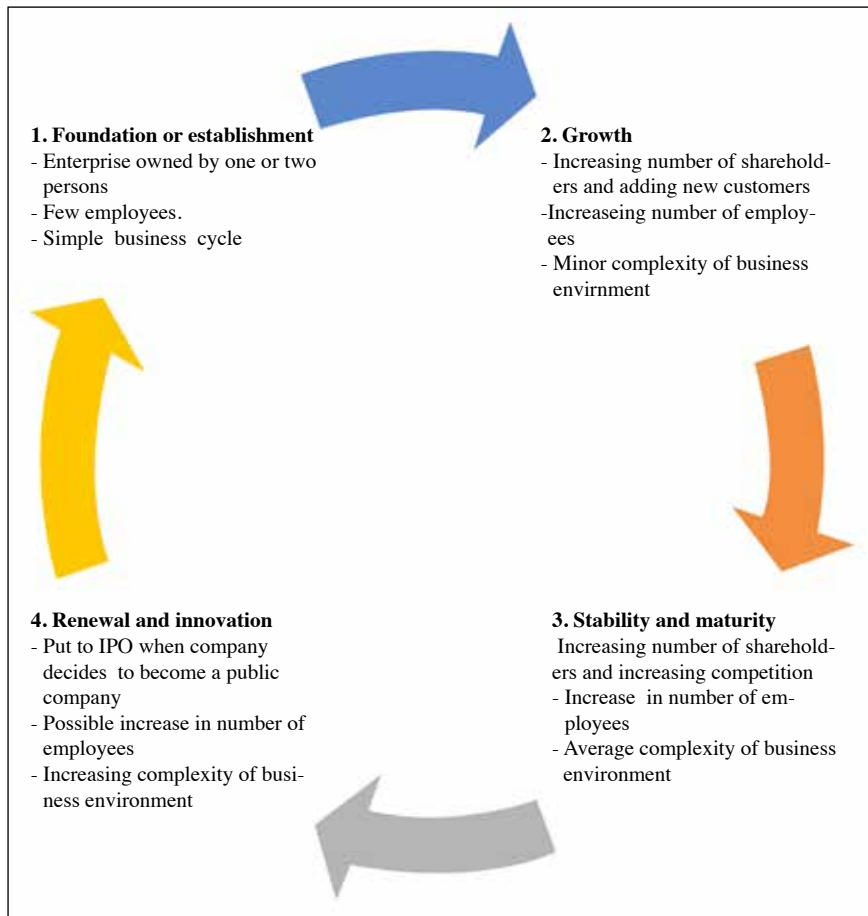
apply appropriate rules and practices of governance. Hence, it can develop future plans, with medium and long term rules, so as to be completed. Therefore, governance becomes an integral part of organization culture and not just independent rules and practices.

Stages of company growth and role of governance

All companies, whether small, medium or large go through the same development stages, usually referred to as “life cycle”, as this cycle varies from one company to another with minor differences, and with different stage periods.

The following figure illustrates the stages of company life cycle:

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The extent of applying governance practices in guidance and control varies for each stage of a company life cycle. The following explains importance of practices for each stage:

Foundation or establishment stage:

The first stage (foundation or establishment stage) is one of the most stages affecting the corporate governance culture. Applying governance principles during this stage means that governance becomes an integral part of company business and becomes a firm belief in employees' mind, not a mere of laws and legislations to be followed. Governance practices at this stage require clear company strategy and good choice of resources to achieve this strategy as well as considering risk identification, which company may face during its journey, and response plans. Guidance practices must be strongly present at this stage, while control practices may not have been formed, yet.

Growth stage:

Governance practices at this stage must be supportive for any growth in order to generate greater revenue by broadening the customer base. The required governance practices must take into account a proper company guidance to achieve its strategy and maintain a supportive supervisory level. Guidance practices must be present strongly at this stage, taking into account a greater presence of control practices than that of the previous stage.

Stability and maturity stage:

This stage is characterized by enhanced performance and improved operational efficiency. During this stage, governance structure is clearly shaped and its practices are promoted. Consequently, those practices should support company credibility and reputation; hence, it is, indeed, a supporter of company presence. Control practices must be mature and

effective at this stage to strengthen the required efficiency with less presence than those of previous guidance practices.

Renewal and innovation stage:

During this stage, companies seek to venture with the goal of increasing revenue and gain access to new markets or create new products. Governance practices need to be strong at its two sides, guidance and control, to ensure company continuity and not to take any ill-conceived adventure.

As in many cases there will be a **fifth stage, i.e. regression stage**. As the company profits and growth begin to decline, here, control governance practices must be effective to protect the rights of all parties from exploitation if the company is no longer able to continue. Sometimes the cycle may continue again if the company is bought by new investors to start the cycle again and start with a new governance culture.

CONCLUSION

At the end of this article, despite the existence of rules and laws for some governance practices, corporate governance is a practice that may vary to the nature of each company. No one corporate governance system that fits all companies.

However, the first stage of establishing a firm has a significant impact on shape and culture of governance. At beginning of a company, practices will not be a burden, as it does not mean that there are committees such as the Nominations Committee, Audit and Risk Committee, or even an internal audit in place.

What that stage requires is a proper guidance to ensure company continuity and build a governance culture in order to achieve an effective and mature governance system in the future, and it develops along with it.

Effective risk department, strong control environment, readiness to deal with future adventure and process integration are all required to achieve goals and governance principles, which are related to responsibility, accountability, transparency and justice.

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The Evolution & Importance of Internal Audit



At the beginning, when companies started noticing an increased rate of Fraud incident as result of lack of attention to the control environment and the weak design and effectiveness of internal controls in the organizations, it was really necessary to create “audit fieldwork” in the private and public sectors. Previously, the audit concept was difficult to comprehend as it was viewed as a control and monitoring function. This continued until the modern management science started to develop and the establishment of the Institute of internal auditors in the early 1940’s. the profession started to move from its policing role into the advisory and business partner role. This was followed by the development of many standards to govern and guide the profession. In addition further alterations to the definition of internal audit were made to properly position the profession within the organization and ensure that people start to realize the importance of auditor and the internal audit function became an integral part of the various types of organizations. However, as the global financial crisis hits globally, board of director’s objective was to increase the organizational profit in order to avoid bankruptcy. Even though some members of the board of directors were auditors. Therefore, organizations started to return back to the old days where audit and control processes were not that important as customer’s satisfaction should be the top in the organization concerns. The customer’s

satisfaction theory states that there is a direct relationship between customer’s satisfactions and profit.

The internal audit function through its disciplined approach enables the management to understand the risk profile of the various processes within the organization, and with the properly designed audit procedures highlight control gaps, and ultimately mitigate controls through the recommendation to enhance or introduce the right controls. However due to the inherent limitation of the internal audit resources the internal audit functions are not able to cope with the all the operational risks that evolve as a result of the organizations operations. Due to this inherent limitation, and in order to for the internal audit function to fully assume its strategic roles within the organization the practices started shifting heavily from simply detecting errors to the assessments of risk management practices and that’s when the new definition of internal audit evolved to be an independent, objective assurance and consulting activity designed to add value and improve an organization’s operations...” The word “adding value” has been identified and explained by many articles or auditors where it can increase the business profitability and reduce the risks in the projects invested or resolve issues that are facing the organizations. Giving the example of the banks before the financial crisis where they were providing

loans to the customers in order to increase their profits through the loan rate without even following the bank’s laws and regulations, which ended up with several bankruptcy cases in the banking sector.

Most of the board of directors are mainly concerned with closing the audit comments without keeping in mind “how can the comments not be repeated from the sections?” Even if the comments are repeated in future, most of them will instruct the department to close it without noticing that it was the same comment written in the previous report. I’m not indicating that profit is not important, it is important and even auditors are checking the financial statements in order to analyze the revenue and costs. However, will the profit levels achieved be sustainable if the organizations’ control environment and governance practices fails operate? And if that is the case, isn’t it suitable to embed the implementation of internal audit recommendations within the key performance indicators of the operational department. It is a question that needs to be carefully thought of, and answered by the executive management and might reshape the role of internal audit in the future.

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