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internal auditor

OCTOBER 2023
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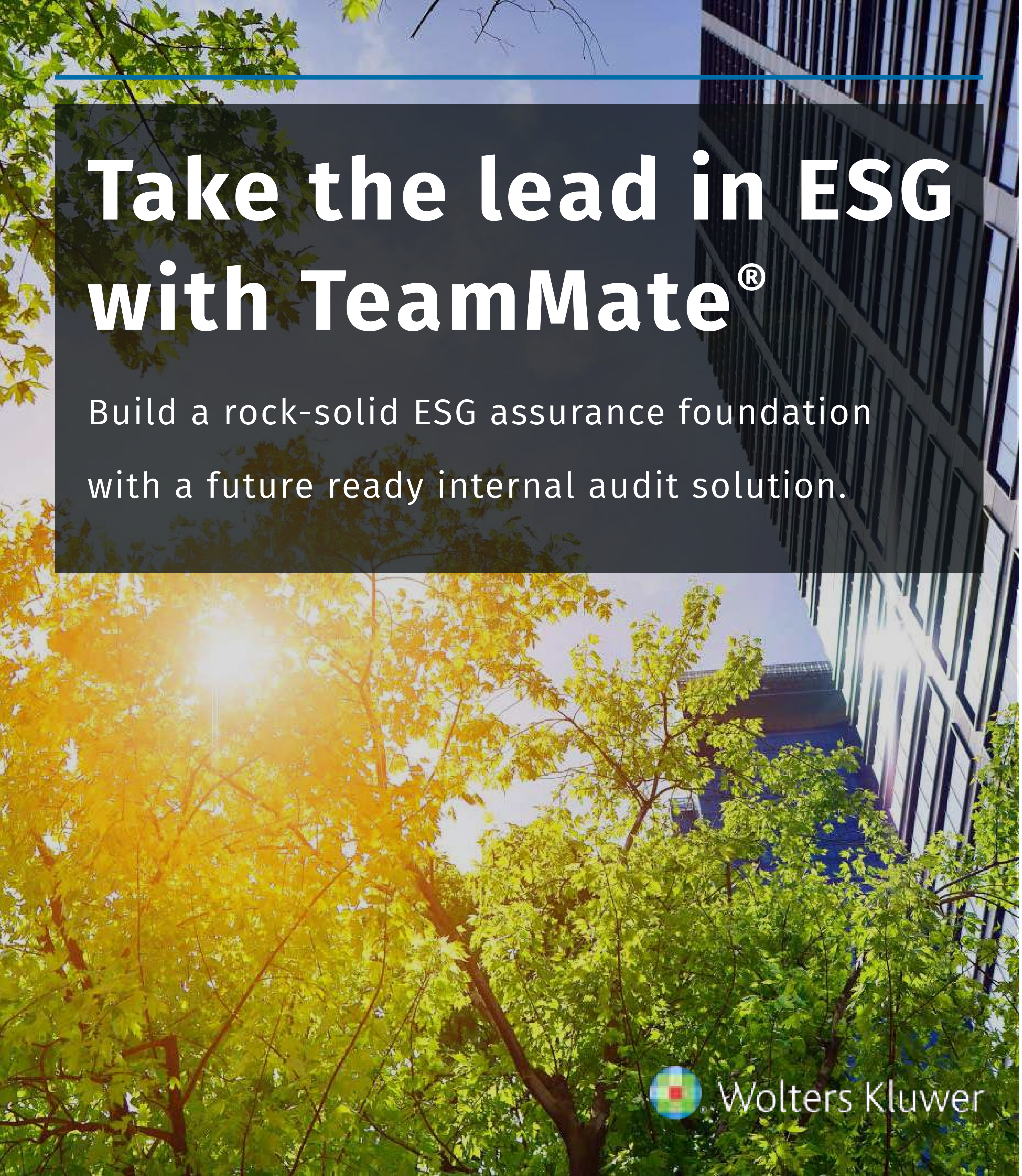

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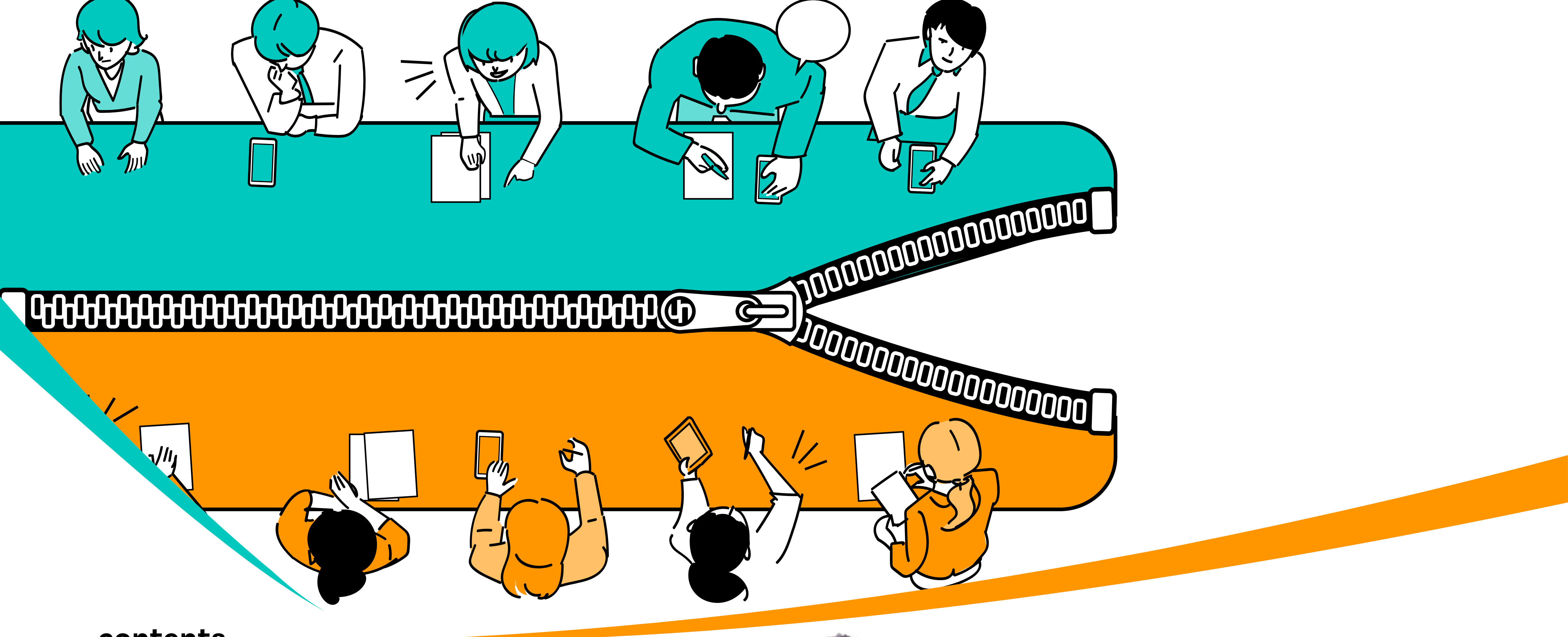

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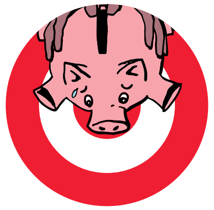

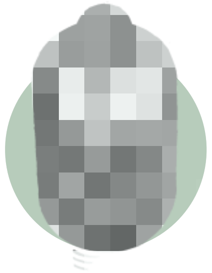

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ceo message

Cultivating Internal Auditing's Future

As we recognize the accomplishments of Emerging Leaders in our profession in this issue of *Internal Auditor*, it presents an excellent opportunity to share some of The IIA's recent developments and initiatives aimed at shaping the future of our profession.

Throughout my discussions with internal auditors around the world, cultivating the next generation of leaders consistently emerges as a top priority. Not only does The IIA conduct research to understand the needs and priorities of college students, we also actively seek innovative approaches to captivate the interest of aspiring internal auditors and demonstrate how a career in internal auditing can fulfill their professional and personal goals.

Last year, the Internal Audit Foundation (IAF) released the Internal Audit: A Global View research report that explored the shifting demographics within our profession. The findings revealed a significant decline in the percentage of respondents under the age of 40, signaling a concerning trend: We are not adequately replenishing the internal audit pipeline. This research emphasized the immediate need for collaborative endeavors to ignite enthusiasm among younger demographics.

To address this issue, The IIA launched several initiatives, including the Global Student Conference, free global student memberships, the Emerging Leaders mentoring program, and the Ignite Conference, all designed for early-career internal auditors. The IAF also has extended its research efforts. In The Internal Audit Student Pipeline, an upcoming two-part report, the Foundation examines how educators and higher education institutions support the development of future internal auditors. Part 1 of the series will be released this month, with Part 2 coming in 2024 and delving into recruitment strategies, essential skills, and typical career progression paths within internal auditing. By implementing these initiatives and committing to their growth in the years to come, we can ensure a resilient, dynamic, and prosperous future for the field of internal auditing.

Further evidence of The IIA's dedication to building a strong future for the profession is reflected in Global Board Chair Sally-Anne Pitt's theme, "Think Different." This theme underscores the importance of — and our commitment to — thinking differently about our identity, our work, and our methodologies. When it comes to attracting new talent, it means thinking differently about how we recruit, retain, and train the next generation of leaders.

I hope that as we celebrate Emerging Leaders in our profession, we also chart a course that fosters young talent, encourages innovative ideas, and remains steadfast in our principles. Together, we can elevate the internal audit profession to unprecedented heights and create a lasting impact on the organizations we serve.

Anthony

Anthony Pugliese

internal auditor

October 2023

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editor's note

Meet the 2023 Emerging Leaders

Each year, *Internal Auditor* magazine features 15 up-and-coming internal audit professionals in its October issue. An experienced panel of judges selects these Emerging Leaders based on their business acumen/leadership, innovative thinking, service to the profession, and community service. The 2023 Emerging Leaders excel in all these areas, showing great promise for the future of the profession.

Take, for example, Uber's Natasha Fernandez, who heads thought leadership projects and takes on challenging reviews that require creativity, flexibility, deep dives into niche areas, and strong relationships with stakeholders. The proof of her skilled leadership are the many requests internal audit receives from stakeholders to collaborate on high-risk areas.

And when it comes to innovation, this year's Leaders are plugging into the latest technologies. Nutrien's Brooke Lobdell developed an SQL script designed to detect potential conflicts of interest using data from multiple platforms. She is now responsible for more than 25 active robots and has written several complete scripts.

This year's Leaders also are passionate about giving back to the profession and sharing their knowledge. Argotrade Supply Group's Hasan Aliyev volunteers in educational workshops and mentors students interested in earning the CIA and CRMA designations. He's also a strong advocate for his affiliate, IIA–Azerbaijan, helping more than 15 members join the organization.

That passion for giving back extends to the communities in which the Leaders live and work. TIAA's Jada Pierre takes on leadership roles in community service initiatives at her company. She is passionate about fighting hunger and supporting access to nutritional meals for those living in food deserts.

You can learn more about Natasha, Brooke, Hasan, and Jada and meet the entire impressive class of 2023 Emerging Leaders beginning on page 32. Congratulations to all!

On a fun side note, we are excited to present our 2023 Emerging Leaders on *Internal Auditor*'s new digital platform. This platform features a more user-friendly experience, with a clean look and additional opportunities to showcase and share all *Internal Auditor* magazine has to offer.

Use the narration feature to let us read to you while you're on the move, receive curated content based on your reading preferences on a personalized channel, watch bonus content such as videos and The IIA's new podcasts, and connect with us on social media — all from the platform. The digital edition also will adapt to your mobile device to offer the best viewing experience. Check out these features and many more and let us know what you think.

Anne

Anne Millage

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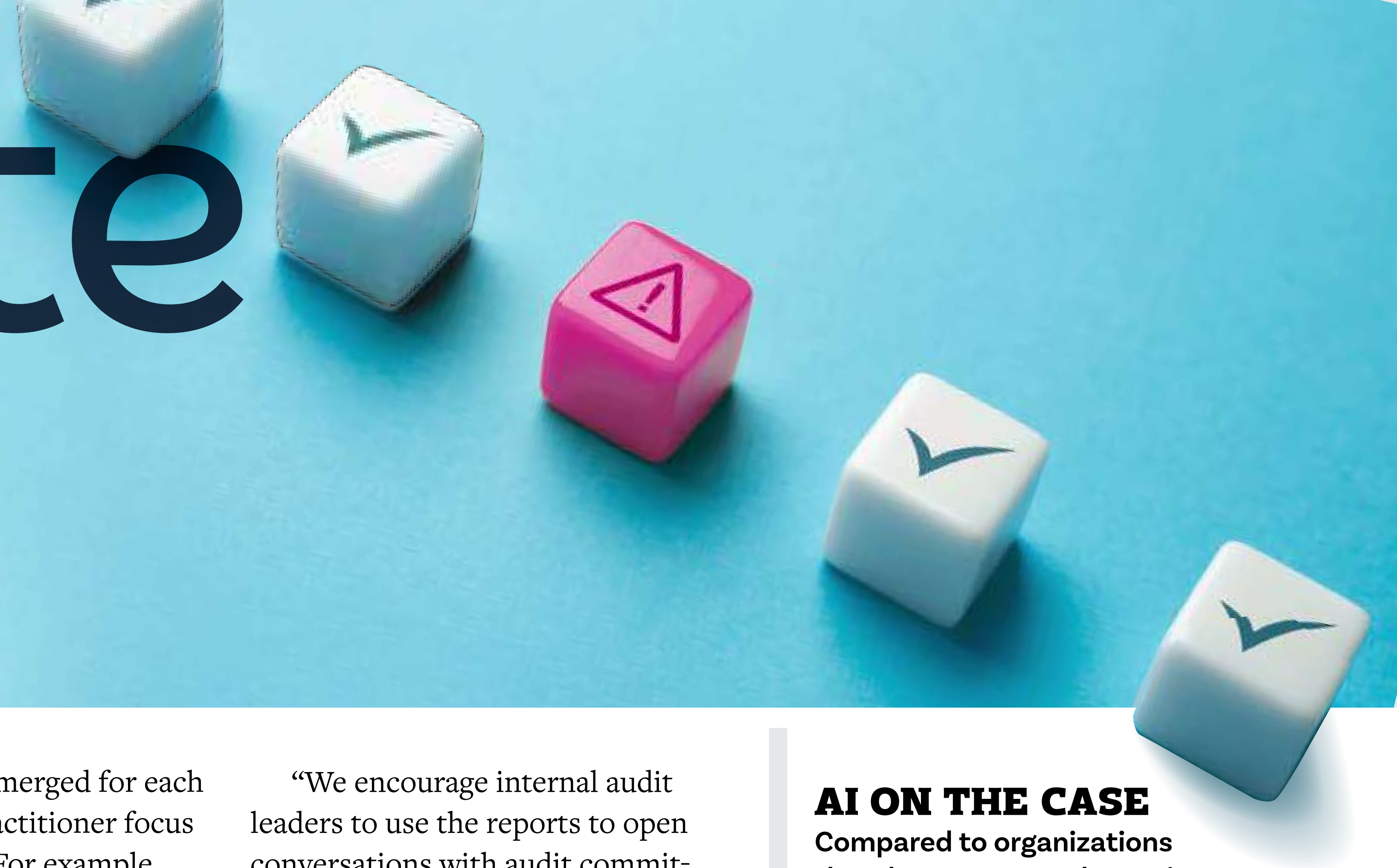

Risk in Focus

Regional themes emerge from groundbreaking IIA global research.

Practitioners around the world named digital disruption and climate change as risks that will continue to grow and require additional resources to manage, according to The IIA's Global Risk in Focus 2024. The new series of reports identifies current and emerging risks for internal auditors in The Institute's six international regions.

The reports are based on a worldwide survey of 4,200 CAEs and directors, as well as focus groups and interviews. The initiative builds off the Risk in Focus report begun by the European Institutes Research Group in 2016.

Unique themes emerged for each region, reflecting practitioner focus and current events. For example, "digital transformation" is the theme for Africa, where a wave of digitalization is helping transform Africa's economies and government systems.

Meanwhile, "interconnectedness" is the theme in Asia Pacific, where internal auditors say risks are complicated by the high level of economic and political interconnections among countries in the region. The other themes are "macroeconomic instability" in Europe, "relationships" in Latin America, "professionalism" in the Middle East, and "collaboration" in North America.

"We encourage internal audit leaders to use the reports to open conversations with audit committees and top management about the most relevant risks for their organizations in the upcoming years," says Javier Faleato, The IIA's executive vice president of Global Strategy and Affiliate Relations.

Two types of reports, one on hot topics for internal auditors and one providing a "board briefing" summary to share with stakeholders, are available for Africa, Asia Pacific, Europe, Latin America, the Middle East, and North America. The reports are available at The IIA's Risk in Focus resource page and the ECIIA website. **—Christine Janesko**

AI ON THE CASE

Compared to organizations that don't use AI and security automation extensively to detect cyber intrusions, ones that do use these tools spent

$1.76 M LESS

108 FEWER DAYS

identifying and containing a data breach.

SOURCE: IBM SECURITY, COST OF A DATA BREACH REPORT 2023

Cyber Disclosures Coming Soon

New SEC cybersecurity rules mandate more transparency.

New U.S. Securities and Exchange Commission (SEC) rules that require publicly listed companies to disclose cybersecurity incidents went into effect in September.

Adopted in July, the Commission's Cybersecurity Risk Management, Strategy, Governance, and Incident Disclosure rules give companies four days to determine if a cybersecurity intrusion is material and to report it to the SEC. The rules allow for a delay if the U.S. Attorney General determines that disclosure would be a risk to national security or public safety.

The new rules also require SEC registrants to describe, in their annual 10-K report, how they assess, identify, and manage material risks from cybersecurity threats, detailing board oversight and management's role and expertise. Foreign private issuers are required to make similar disclosures annually and in the event of a material cybersecurity breach.

The new rules reflect the SEC's view that cybersecurity is not just an IT issue but a business issue that requires the full attention of today's organizations.

"Currently, many public companies provide cybersecurity disclosure to investors," SEC Chairman Gary Gensler said in a press release. "I think companies and investors alike, however, would benefit if this disclosure were made in a more consistent, comparable, and decision-useful way." **—Logan Wamsley**

FEELING THE EFFECTS

Globally, financial institutions are beginning to experience the fallout from Russia-related sanctions:

76%
Noted increased regulatory scrutiny in 2022.

88%
Identify sanctions risk assessments as the top investment area in their compliance efforts.

66%
Expect a further increase in spending related to sanctions compliance.

SOURCE: GRANT THORNTON, RUSSIA-RELATED RISKS TAKE HOLD

WORLD of WORRIES

Global chief risk officers list top external risks to their organizations:

Macroeconomic indicators
86%

Pricing and supply distributions of key resources
55%

Armed conflict and the use of weapons
50%

Regulatory changes, compliance, and enforcement
50%

SOURCE: WORLD ECONOMIC FORUM AND CENTRE FOR THE NEW ECONOMY AND SOCIETY, CHIEF RISK OFFICERS OUTLOOK

TOP REASONS 4 IN 10 U.S. WORKERS with paid time off take less than their employer allows:

52% DON'T FEEL THE NEED.

49% WORRY ABOUT FALLING BEHIND AT WORK.

43% FEEL BADLY LEAVING COWORKERS WITH EXTRA WORK.

19% WORRY IT MIGHT HURT CHANCES FOR ADVANCEMENT.

SOURCE: PEW RESEARCH CENTER, "MORE THAN 4 IN 10 U.S. WORKERS DON'T TAKE ALL THEIR PAID TIME OFF"

ASK AN EXPERT

Trader Woes

Sharon A. Martin is principal, Global Trade, at EY in Chicago.

How are geopolitical risks affecting organizations' global trade strategies?

Many years of geopolitical instability, supply chain disruptions, and nationalistic policies have resulted in complex regulations impacting organizational approaches to global trade strategies. Businesses are facing higher customs duties, expanded export control restrictions, and more attention and enforcement over ESG issues. Organizations today face a heightened need to pursue global trade strategies that support effective, compliant risk management while also managing costs.

How should organizations respond to the risks?

Organizations with supply chain visibility through access to import and export data and knowledge of the physical movements of goods are able to identify risks and quantify trade-related costs. Equipped with this information, organizations can build effective monitoring programs. They also can cut costs by evaluating opportunities to reduce customs duties. "Smart" raw material sourcing — for example, to access preferential trade agreements or move to more favorable locations not subject to the "301" tariffs — could significantly reduce a company's costs related to trade.

Cross-functional support is another important consideration. Geopolitical risks intersect with many functions within an organization, including finance, logistics, trade compliance, procurement, and legal. Continuing and new requirements, particularly those related to ESG, such as forced labor, the EU's Carbon Border Adjustment Mechanism, and deforestation regulations, require information and awareness from each of these functions to proactively address the risks.

Finally, talent and resource management is key. Intentional hiring and well-established, compliant, and technology-enabled global trade processes can help organizations maintain the flow of goods with less supply chain disruption. Companies that achieve effective trade operational processes can free up resources, focus on strategies to manage risks, and design programs for reducing customs duties.

Many years of geopolitical instability, supply chain disruptions, and nationalistic policies have resulted in complex regulations impacting organizational approaches to global trade strategies.

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basics

When Management Is Unresponsive

Internal audit's effectiveness depends on management's willingness to address findings. Josh Margraf

As an internal auditor, it is satisfying to see how findings and recommendations help organizations improve. It feels good knowing the effort put into audit work can enhance operations. However, internal audit's effectiveness greatly depends on management's willingness to address findings and recommendations.

Symptoms of poor tone at the top can impact internal audit's ability to be successful. Internal audit can look to these indicators to gauge how effective it can be in the organization.

Similar Root Causes

Persistent issues that are prevalent and overlap different audits (e.g., little documentation of internal controls or no clear policies or procedures) may indicate management is slow to, or does not, address significant issues. During multiple audits at one organization, I discovered the root cause of performance issues and noncompliance with procurement requirements was the lack of detailed policies that clearly outlined procedures and identified the staff responsible for performing them.

Staff, from accountants to project managers, did not have sufficient guidance for carrying out their responsibilities. They did not know how to document and review contractor invoices or assess consultant performance, and there was no clear accountability. Management did not examine the thoroughness of the policies or whether they were effectively implemented.

Internal audit can identify root causes by reviewing prior audits, risk assessments, and audit plans for persistent issues, and then summarizing the results in a special report that shows the frequency of findings, their similarities, and associated risk areas. The report should be formatted to best suit the organization, such as a briefing or flash report, to have the best chance of acceptance by management or the governing body.

In another instance, I used a recurring report to update the audit committee on findings and open recommendations. I also reported annually on risk areas, including causes of prior findings. These reports demonstrated a continued need for staff guidance on procedures as a root cause. Management indicated policies were being updated or drafted but did not specify a time frame for completion.

Although a special report can call further attention to the need for improvements, management must be willing to act. Without fixing root causes, underlying problems will remain and result in similar findings and recommendations.

When Risks Outweigh Resources

If internal audit regularly identifies multiple high-risk areas during annual audit planning but management refuses to increase audit resources (e.g., staff or funding) and instead encourages a focus on lower risk areas, audit effectiveness will be diminished.

Throughout my career, I have routinely identified high risks. For example, I once discovered an external party cashed forged checks in the company's name. When discussing the issue with management, I was told that fraudulent checks were not internal audit's concern, and law enforcement would investigate. However, management never explained how someone obtained a check to forge and did not provide investigation results.

Internal audit's annual risk assessment used these types of findings to identify high-risk areas and request additional resources. Management refused to increase resources because historically internal audit reviewed vendor lists, petty cash, and employee expense reimbursements, with few findings.

Rather than request more resources, substituting low-risk audits with audits of high-risk areas can help ensure coverage of significant risks. Doing so may require a management or audit committee champion to help develop a strategy for expanded audit coverage.

Because of the limited resources, I regularly discussed with the chief information officer (CIO) how internal audit could address areas of concern, such as IT contract oversight, as part of planned audits or by other means. Internal audit also invited the CIO to provide updates on IT activities at each audit committee meeting.

Internal audit needs high-level support to target high-risk areas. If management prefers audit efforts focused on low-risk areas, internal audit may not be able to effectively address or develop recommendations to mitigate the bigger risks.

Internal audit needs high-level support to target high-risk areas. If management prefers audit efforts focused on low-risk areas, internal audit may not be able to effectively address or develop recommendations to mitigate the bigger risks.

Failure to Address Hotline Reports

An ethics hotline is a convenient way for employees to report wrongdoing anonymously. However, its worth relies heavily on management's response to it. Although hotline reports may not signify good news, they provide insight to areas for improvement.

At one organization where I monitored hotline reporting, I noticed that once the organization started using a third-party vendor for report intake, the hotline received more reports within the first few months than any time previously. Reports ranged from unfair promotion practices, to employee labor mischarging, to ethics violations. This not only demonstrated that staff were aware of and using the hotline, but it also identified unaddressed issues. When I presented the hotline statistics and reports, management showed little concern, claiming the staff was simply venting.

Not every hotline report warrants a full investigation, but it should be reviewed and discussed to determine the extent something is wrong and can be fixed. I had to work through general counsel to ensure reports received adequate attention and fact finding.

Management is not addressing underlying staff concerns if the number of hotline reports is higher than prior periods and similar issues are regularly reported. Further, if management shows indifference toward hotline reporting, it also is likely to dismiss audit findings.

A Commitment to Improvement

Even skilled auditors' success is limited if management has little interest in addressing findings and recommendations. It is possible for management to change, and internal audit can find ways to help management address risk; however, such efforts require time and resources that internal audit may not have.

According to *The Politics of Internal Auditing*, by Patricia Miller and Larry Rittenberg, effective and lasting change within an organization can be difficult to make from the bottom up. For internal audit to be effective, the tone at the top should reflect an attitude that is open and committed to improvement.

Experiencing any of the aforementioned issues can signify the audit work is not the problem. To realize their full potential, internal auditors may want to take their skills to organizations more attuned to internal audit's value.

Josh Margraf, CIA, CISA, CFE, is a government auditor in Los Angeles.

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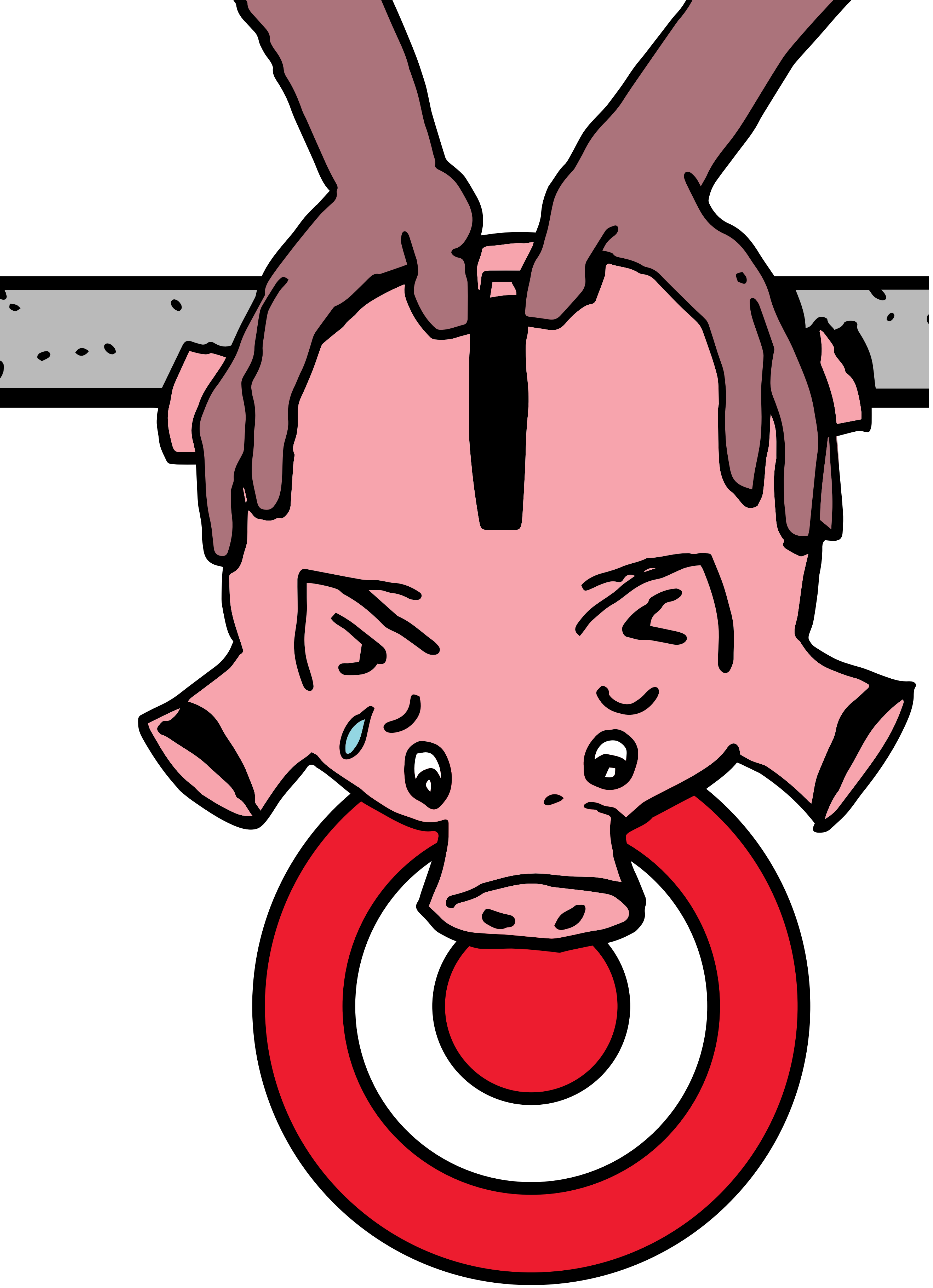


risk

Testing Risk Resilience

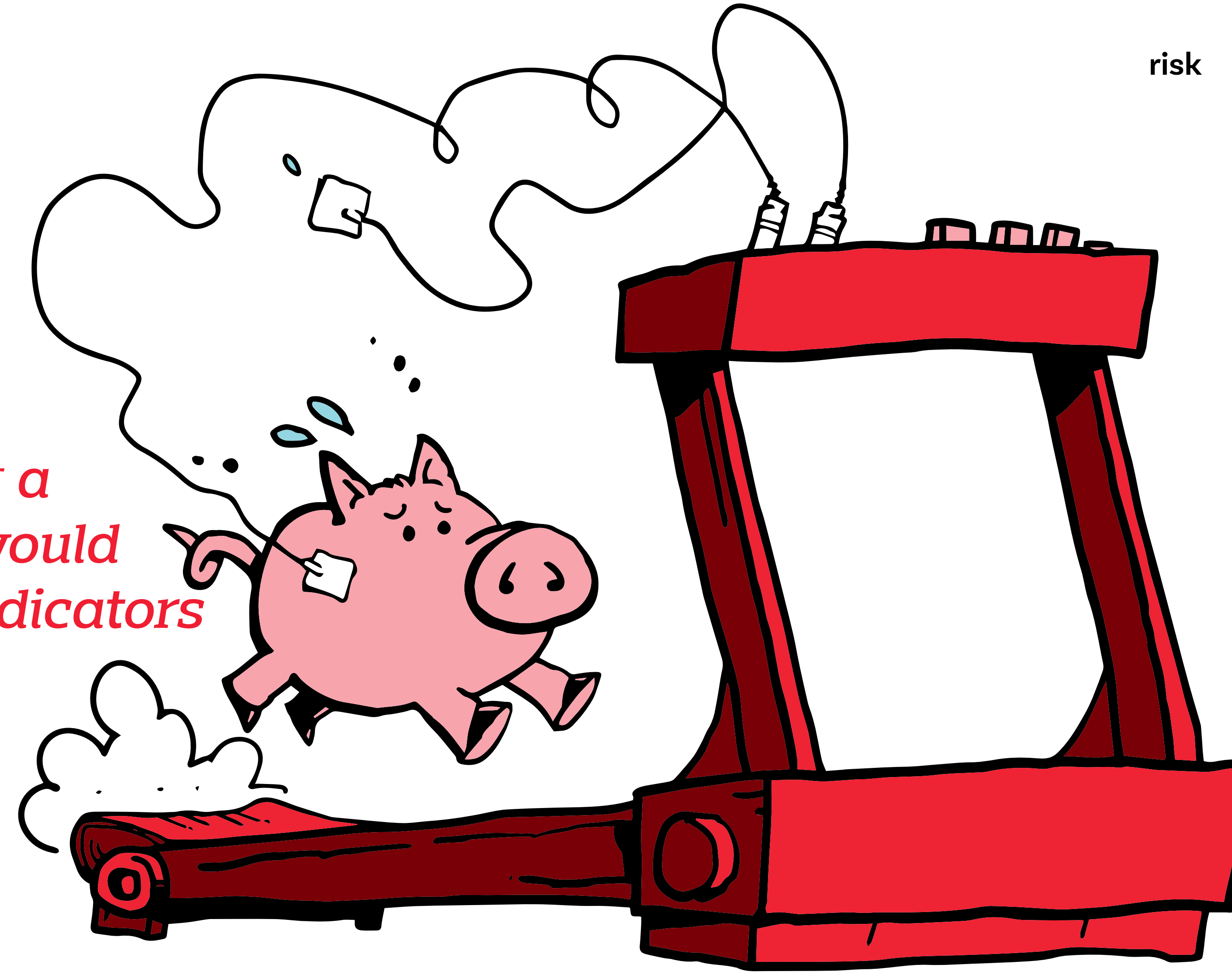
As stress testing grows more complex and regulated in daily risk operations, internal audit can learn lessons from the banking industry. Adrian Gutierrez Dave Chow

In March, the fall of Silicon Valley Bank and First Republic Bank in the U.S. brought back memories of the global financial crisis that began in 2007. According to documents disclosed by regulators, both bank failures were textbook examples of poor risk management and supervision. A root cause of the collapses was lack of oversight by risk management functions and regulators of the mounting risk the banks faced.

As in the earlier financial crisis, the failures reinforced the need for stress testing. Stress tests are exercises financial institutions perform to test their resilience to adverse economic conditions.

Stress tests alone could not have saved the banks, as they are only one of several essential elements for prudent risk management. The banks' failure to prepare for interest rate changes resulted from a combination of deficiencies. However, adequate stress testing could have helped the banks identify mounting risks.

Since the financial crisis, some banks have incorporated or enhanced stress testing into their risk management processes. The tests have proven particularly useful in helping organizations navigate through



Stress tests boil down to answering a short, yet difficult question: What would happen to the organization's risk indicators in an economic crisis?

macroeconomic uncertainties resulting from the COVID-19 pandemic, inflation, and rising interest rates.

As stress testing has grown more complex and regulated, internal audit is assessing aspects such as how stress test programs are implemented and their macroeconomic and business hypotheses. As other industries incorporate stress testing in their daily risk operations, they can learn lessons from the banking industry.

How Stress Tests Work

Stress tests boil down to answering a short, yet difficult, question: What would happen to the organization's risk indicators in an economic crisis? Banks consider these questions to help identify mounting risks and implement their risk-appetite framework by setting limits and early warnings for the key risk indicators (KRI).

In banking, the results of stress tests determine two key variables: the level of capital and liquid assets the institution would need to survive under severe, yet plausible economic conditions. Stress tests are categorized according to different criteria such as:

- Whether they are used for internal or regulatory purposes.
- The type of risk modeled (i.e., credit, market, liquidity, or operational risk).
- The levels at which the tests are run. Tests could range from simple portfolio analyses to complex institutionwide simulations.

Technical complexity and organizational arrangements vary according to the size and business model of the company.

The regulatory environment also is relevant. Regulatory stress tests can be demanding because they require banks to adopt methodologies and data frameworks designed for the entire financial industry.

To be efficient, some banks leverage this regulatory framework when they implement their internal stress-testing programs. Moreover, both regulatory and internal exercises often use variations of existing regulatory models, such as the internal ratings-based model for credit and interest rate risk in the banking book for interest rate risk. Internal audit can help organizations use stress testing in three key areas: governance, information systems, and analytical models.

Governance and Decision-making

Organizational and accountability structures are crucial for the success of stress-testing programs. The test design requires involving experts from different business, risk, and data functions. Stress tests are iterative processes that require evaluating competing hypotheses and scenarios before arriving at a result. Senior management is expected to challenge the hypotheses, scenarios, and results of the tests as well as set the KRIs and action plans to accept, mitigate, transfer, or limit the risks faced by the institution.

All material aspects of stress testing should be documented. Policies and procedures should reflect the organizational arrangements, tools, data architecture, and methodological analyses supporting the final and competing hypotheses and scenarios. Although striking a balance between agility and traceability can be challenging, internal audit can recommend documentation practices and facilitate collaboration among different departments.

Some key questions that internal audit should answer are:

- Are the roles and responsibilities clearly documented?
- Do policies and procedures cover the entire life cycle and tools of the organization's stress-testing program?
- Does senior management challenge the results effectively?
- Are decisions consistent with the results of the stress tests?
- How do the stress-testing results compare with external regulatory and sectorial benchmarks?

Management Information Systems

Data is necessary to implement stress tests. The flow of information through management information systems (MIS) is pivotal. First, the MIS captures the stock of assets and liabilities of the bank, including any useful information for risk management. This information is used to calibrate behavioral hypotheses to simulate the impact on the bank's portfolio.

Senior management is expected to challenge the hypotheses, scenarios, and results of the tests as well as set the KRIs and action plans to accept, mitigate, transfer, or limit the risks faced by the institution.

Second, the MIS computes the macroeconomic scenario's impact on the portfolio and risk metrics. The system summarizes data to provide senior management and all the areas involved with an overview of the results for each scenario. This requires defining a report structure and relevant KRIs to provide senior management with complete, accurate, and meaningful information for decision-making.

A good understanding of the data architecture will help internal audit determine the frequency and scope of the audits. If stress tests rely on daily operations or the MIS, the audit steps should be more efficient. However, if the organization has a separate risk engine or relies on manual inputs, the audit plan needs to address them.

Key questions internal audit should ask include:

- Are data flows fully documented? Does the bank rely on automated processes or manual tasks?
- What are the controls to ensure data quality?

Emerging risks such as climate change, cybercrime, and supply-chain disruption will force more industries to adopt stress testing tools into their strategic planning and risk management processes.

- Can the MIS produce timely and reliable results, even under stressed circumstances?
- Are the final reports complete and understandable?

Analytical Models and Judgment

When calibrating the hypotheses of a scenario and quantifying its impact, institutions use two approaches: analytical models and expert judgment.

Statistical and mechanical models link the behavior of KRIs (e.g., probabilities of default of their clients' level of collections) to the economic conditions. These analytical models can range from simple correlation analyses to complex credit risk models based on historical data.

Banks use expert judgment to complement the results of analytical models or introduce behavioral hypotheses, based on the experience of the risk or business analysts. Internal audit can help by hiring professionals who are experts with advanced models and data quality audits. In evaluating models and judgment, auditors should ask:

- Is there sufficient historical data to develop an analytical model?
- Are the models conceptually sound and fit for purpose?
- Are analytical methods adequately calibrated and implemented?
- Do analytical models reflect actual market conditions or need further adjustments?
- Is expert judgment reasonably supported?

The Road Ahead

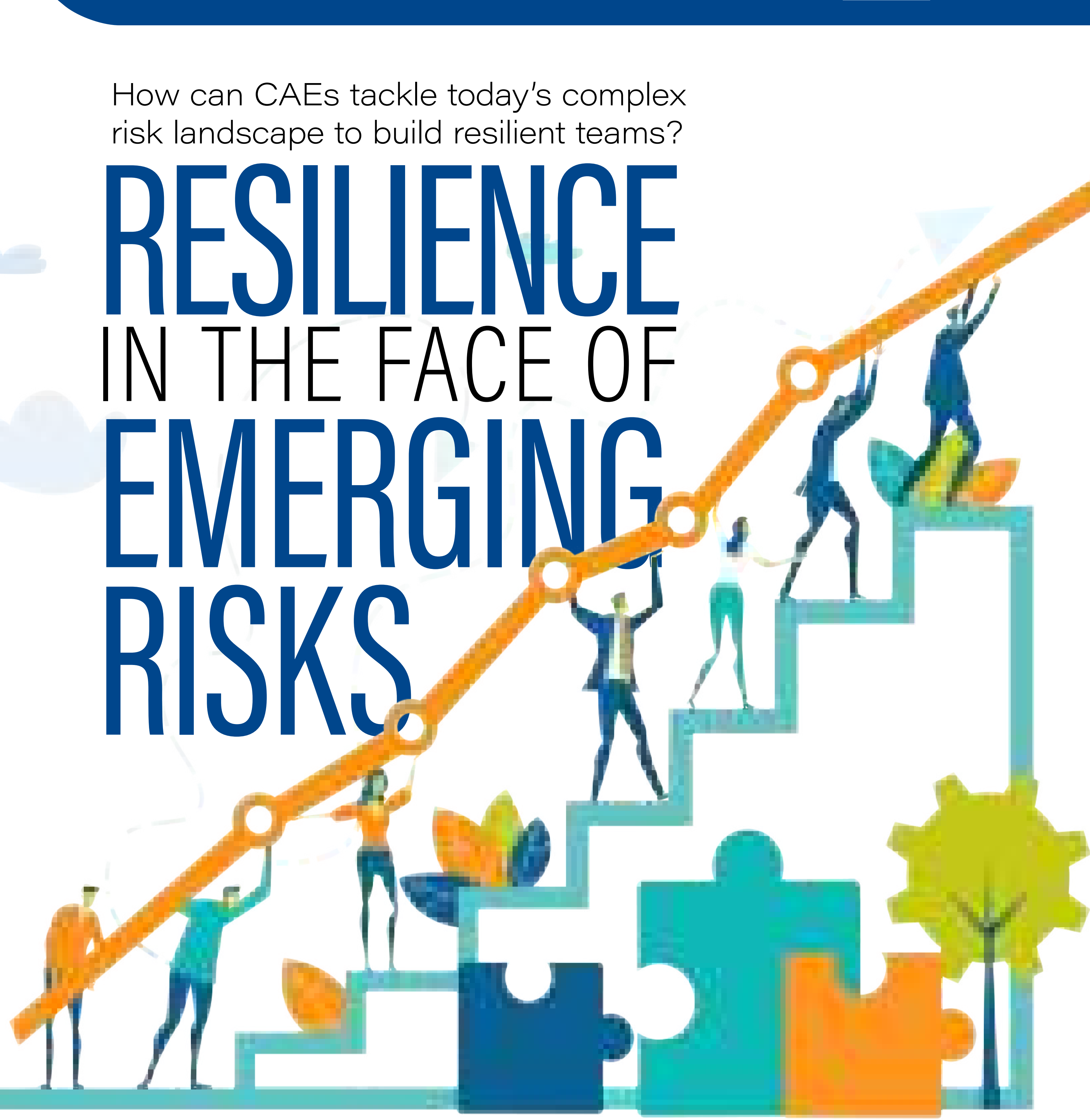
In a fast-changing and uncertain macroeconomic environment, stress testing will continue to play a crucial role in organizations and be scrutinized by regulators. Emerging risks such as climate change, cybercrime, and supply-chain disruption will force more industries to adopt stress-testing tools into their strategic planning and risk management processes.

Internal audit can help improve the stress-testing capabilities of organizations by challenging the design, implementation, and results of stress tests. As stress testing grows more complex, internal audit should follow an iterative, multiyear approach to fully cover the life cycle of these programs.

Adrian Gutierrez is risk modeling audit manager for Abanca Corporación Bancaria in A Coruña, Spain.

How can CAEs tackle today's complex risk landscape to build resilient teams?

RESILIENCE IN THE FACE OF EMERGING RISKS



There's no question that audit teams have been under immense pressure lately. From increasing audit committee and management expectations to talent shortages that arose with the COVID-19 pandemic and have no end in sight, internal audit is certainly feeling the heat to keep up.

Not to be the bearer of bad news, but those demands and challenges likely won't subside and are only going to increase as new reporting requirements — including associated assurance requirements — are adopted for environmental, social, and governance (ESG).

Today's internal audit teams truly find themselves between a rock and a hard place. The good news is audit leaders can take these challenges and turn them into opportunities to maximize value. Let's break down what that could look like in practice.

MAXIMIZE EFFICIENCY

Take a critical look at internal audit's processes — most functions can find opportunities to streamline and save time across at least a few activities. One such opportunity is to leverage technology to automate routine, manual tasks to free up valuable time to focus on higher-value work.

BUILD AN EFFECTIVE TEAM

One of the most important areas to consider when developing plans for addressing existing and emerging risks, like ESG, is evaluating the capabilities needed to perform the work. If there are gaps in skills, create a plan to fill those needs.

There are three basic models for doing so:

1. Build it. Develop the existing internal audit team. Most auditors will need training on ESG risk areas that are material to the organization so they have adequate context to apply their skills. Also assess whether team members need additional training in crucial areas such as critical thinking, root cause analysis, problem solving, and facilitation skills.

2. Hire it. Get creative with the hiring process to find the right skills and bring in fresh perspectives. Hiring nontraditional candidates with expertise in various aspects of ESG, such as environmental engineers, human resources specialists, and other ESG professionals, can help fill any gaps.

3. Rent it. Bring on third parties to supplement the existing audit team or outsource this effort completely to an organization with the required skills and knowledge.

Of course, you can also take a blended approach by supplementing your current team with new hires or third parties who complement the function.

EVALUATE SKILLS

Most organizations have established processes for bringing on third parties to fill particular needs, but fewer internal audit teams have mature processes in place to identify the skills and capabilities required to create resilient teams.

Assess current capabilities against changing requirements by:

1. Identifying current and future skills and capabilities. It is imperative to invest time and effort to stay abreast of changes affecting the profession, as well as all the factors that could impact the organization and industry. Look for themes across sources and consider the implications to the organization, industry, and the overall economy. As you consider those themes, determine what new skills or capabilities will be required to understand the risks and opportunities.

2. Assessing team and individual capabilities. Once needs are identified, compare the audit team's current skills with what is needed to address emerging risk areas and determine any gaps. To fill gaps, consider the interests and aptitudes of the team and pinpoint which individuals are motivated and want to expand their knowledge of a new topic or discipline.

3. Creating development opportunities. Encourage team members to research opportunities and build a development plan that empowers them to take ownership and improve personal accountability for new efforts. Next, consider how to balance training costs with budget limitations and determine if an alternative, such as a blend of formal training, personal research, mentoring, and application of new learnings, will be effective for the organization's needs.

MAKE AN IMPACT

Helping team members develop the skills needed to make an impact as the organization takes on the challenges of emerging risks, including ESG disclosures, is essential to building an audit organization that is resilient and adds real value.

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GAM is the premier event for internal audit innovators, leaders, and trailblazers to engage with each other on solving today's business and audit challenges and exploring tomorrow's new frontiers.

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fraud

Buying Into Trouble

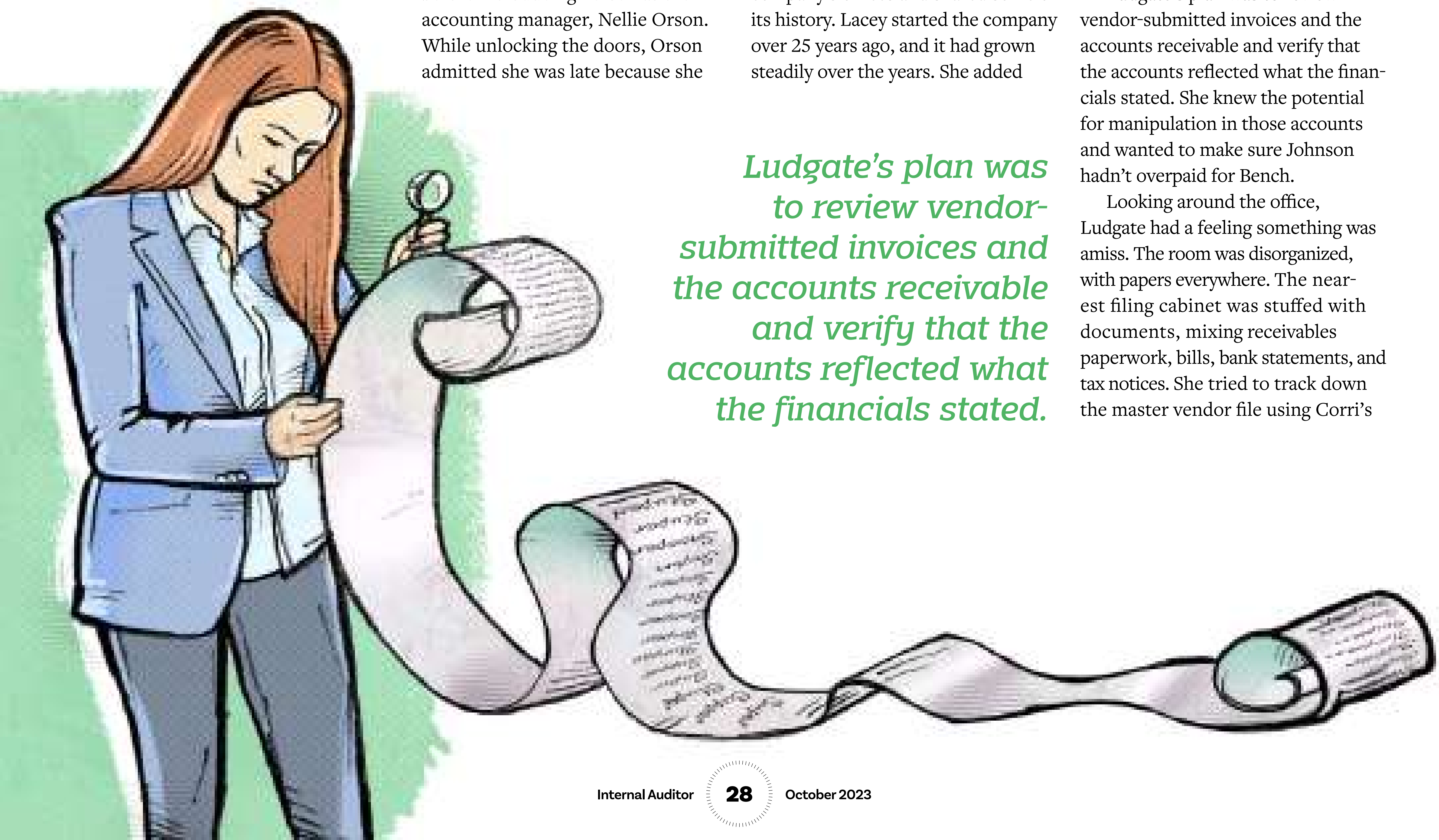
Following a lack of due diligence, an auditor is determined to leave no paper unturned.

Laura Harris **Joshua Clark**

Ester Ludgate was on her way to Kansas City to audit Bench Inc., a company that her employer, Millbrook, had just acquired. Although, due diligence was performed as part of the acquisition, it did not involve a review of operations. Ludgate was determined to find out if Bench was the company it claimed to be.

Millbrook, a manufacturer of midgrade tools at moderate prices, was a growing company. Owner

Jonas Johnson had jumped at the chance to purchase Bench, a producer of specialized wrenches. Bench owner, Paul Lacey, was looking to retire and had quickly agreed to Johnson's market-friendly offer.



Upon her arrival at Bench, Ludgate found the parking lot empty and the doors locked. She had just taken a sip of her coffee when a car pulled up. A woman emerged from the car and apologized profusely before introducing herself as the accounting manager, Nellie Orson. While unlocking the doors, Orson admitted she was late because she had overslept. She said she had been working late hours because all of Bench's staff had abruptly quit the previous week after learning Lacey had sold the company.

Orson showed Ludgate around the company's offices and shared some of its history. Lacey started the company over 25 years ago, and it had grown steadily over the years. She added Bench's staff had always been a close-knit group. Orson directed Ludgate to an office she could use during the audit and provided a computer, both of which had been previously used by Orson's assistant, Kyla Corri.

Ludgate's plan was to review vendor-submitted invoices and the accounts receivable and verify that the accounts reflected what the financials stated.

Ludgate's plan was to review vendor-submitted invoices and the accounts receivable and verify that the accounts reflected what the financials stated. She knew the potential for manipulation in those accounts and wanted to make sure Johnson hadn't overpaid for Bench.

Looking around the office, Ludgate had a feeling something was amiss. The room was disorganized, with papers everywhere. The nearest filing cabinet was stuffed with documents, mixing receivables paperwork, bills, bank statements, and tax notices. She tried to track down the master vendor file using Corri's computer and easily found a copy of it without having to enter a password.

The vendor master file had never been updated and included thousands of names; every vendor who had ever submitted an invoice was still listed. The file was several pages long and there were numerous blanks where information was missing.

Ludgate sighed and chose 55 names to inspect that were missing information such as phone numbers and addresses. As she looked over her pages, one name stood out: Super Supply. The company was listed with many spellings, including Super Supply, Super Supply Co., and Supper Supply. It might have been sloppy typing, but it seemed suspicious.

Next, she began her search for supporting documentation. The company was billed at least once a week, and even with the support documents, Ludgate wasn't sure what it supplied. Additionally, the invoice amounts were all just under $5,000. She recalled Orson sharing that invoices over $5,000 required two signatures.

When Ludgate found the hardcopy invoices, she knew she had a problem. She had never seen such a mess. They looked like copies of copies, and as if someone had manually covered fields with liquid corrector and handwritten in new information. The wrinkled lines in the original version copied through to the photocopy, adding to the disheveled presentation.

The combination of printed text, handwritten text, and other seemingly random areas whited out made Ludgate suspicious. The areas that someone had attempted to cover made her think it was an attempt to hide a processing stamp. Even the invoice numbers stood out. They were consecutively numbered, as if Bench was Super Supply's only customer.

Ludgate sighed. Fake invoices were not what she was hoping to find at Bench. She would have to tell Johnson immediately. The counterfeiting was further confirmed when Ludgate went to send a message to Johnson on Corri's computer and found an account for Super Supply still in the web browser email.

When Ludgate asked Orson if she knew anything about Super Supply, Orson explained that the accounts payable department would issue checks the same day it received invoices from Corri. Super Supply always included a request-for-funds form, and Corri told accounts payable that she would happily pick up the checks and deliver them because

The combination of printed text, handwritten text, and other seemingly random areas whited out made Ludgate suspicious.

the company was on her way home. Ludgate had Orson find the copies of the bank checks, and she saw that someone named Katie Smith cashed them at a few different money service stores.

After talking further with Orson, Ludgate realized Orson did not know about the fake invoices. In fact, when Ludgate revealed what Corri had been up to, she was genuinely upset and concerned.

Orson explained that Corri had been her assistant for over five years and was the first to arrive every morning and even brought Orson a special coffee every day. She had no idea about the billing scheme or that it had cost Bench more than $75,000.

After a few moments of silence, Orson hung her head. She told Ludgate how, a few years ago, Corri had been stressed because her mother was ill. She had offered to work more hours and even clean the office to earn extra money. She did this for only a few months before her mother died.

Not long after, Corri's demeanor improved. She began taking more care in how she dressed, and she even bought a new car. She explained that her mother had left her some money in her will. Although it made sense at the time, now Orson couldn't reconcile the disparity between the desperation for money one month and the overabundance of it the next. Insurance or inheritance seemed like an easy answer, and Orson recalled not wanting to pry during such a difficult time. Even worse, Corri's mom turned out to be Katie Smith.

When Ludgate and Orson presented Corri with the evidence of the fraud, she confessed. She explained that when she was left alone in the office at night, she saw the opportunity to commit fraud and couldn't say no for the sake of her dying mother. She said she figured it would not hurt a successful business to lose a little money. With so many documents kept around the office, she didn't think anyone would notice the scheme.

Corri said she had not meant for the fraud to continue after her mother's death, but the money was too tempting. When she learned Lacey had sold the business, she promptly left, hoping the new owner would not find out about her scheme. Corri eventually agreed to a deal with prosecutors that included paying restitution to the company.

Laura Harris, CFE, is a research specialist for the Association of Certified Fraud Examiners in Austin, Texas.

Lessons Learned

- **Due diligence is important before buying a business and should include an audit of operations.** If Johnson had sent Ludgate to audit the books before finalizing the deal, she would have discovered the problems and alerted Lacey to the fraud that was taking place.
- **Accounts payable personnel and internal auditors should be trained to analyze invoices for signs of fraud.** The invoices submitted for Super Supply had several red flags that should have been noticed. Additionally, storage of records should be well-organized so auditors, regulators, and others can understand the organization's accounting process.
- **Businesses should establish appropriate segregation of duties.** Employees should not be authorized to pick up or deliver payments or refunds to vendors. Super Supply used only a post office box, but the address was fake. Post office boxes have numerical addresses, but Super Supply's contained a letter. As a result, any payments Bench attempted to send to Super Supply through the mail would have been undeliverable and may have alerted the accounting manager to the scheme much sooner.
- **Fraud often isn't a one-time occurrence.** Once scammers learn they can get away with their scheme, they will continue to do so. Often, the fear of being found out decreases with each successful theft.
- **Changes in behavior and lifestyle can be a red flag for fraud.** While sometimes people buy a new car with inheritances, explanations about a sudden windfall of money often aren't true. Especially when an employee has been known to be under financial pressure, a change in circumstance might warrant a closer look at the individual's business actions.

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Internal Audit 4.0: Framework for the future

Aiming for purpose-driven, digitally powered IA

Introducing Internal Audit (IA) 4.0—a market-leading framework for expanding the remit of IA. By aligning IA outcomes with the organization's purpose, helping accelerate organizational change and learning, and further embracing digital, the IA function can upgrade and maximize its impact and the value it delivers—all of which has been considered and expanded upon within our IA 4.0 framework.

What's new

Purpose

Integrating IA's role and scope with the organization's purpose introduces a fresh approach to functions. This enables a more intentional approach to support specific outcomes and contributions to the organization, attract top talent, foster stronger stakeholder engagement, and make smarter choices.

Accelerate

Organizations that have thrived in uncertain times were the ones that could learn to adapt and act quickly. And it's here where we think IA can stretch its remit further—by helping to accelerate organizational learning and management action.

Digital

Many functions have embraced data analytics, but few view "digital" broadly enough or leverage capabilities to support the entire audit life cycle. Applying digital requires a mindset to consider the art of the possible while taking a highly systematic approach to using technology.

Mindset

Anticipating risks and opportunities and responding rapidly requires agile and digital capabilities—and the right mindset. Without that mindset, those capabilities may be unused or underused. The aim is to develop a mindset that embraces continuous learning—experimenting and iterating at a faster pace, with ongoing communication and embedded agile methods. This mindset enables the function to pursue incremental improvements that generate lasting and relevant change.

Internal audit megatrends

Integral to IA 4.0 are several megatrends driving changes across strategy, people, process, technology, and data. From assuring and advising on Trust equity to strengthening stakeholder relationships to adopting new technologies and capabilities to develop efficiencies and resiliency, the culture of continuous improvement and innovation is here.

Explore our IA megatrends 5x5 series, highlighting 5 insights and 5 actions you can take related to the following megatrends:

- Organizational Trust
- M&A
- Cybersecurity
- NFT implementation
- Business transformation
- Automation
- Assurance by design

Additional megatrends to come.

Explore ways IA can maximize the value it delivers:

https://www2.deloitte.com/us/IA4-0

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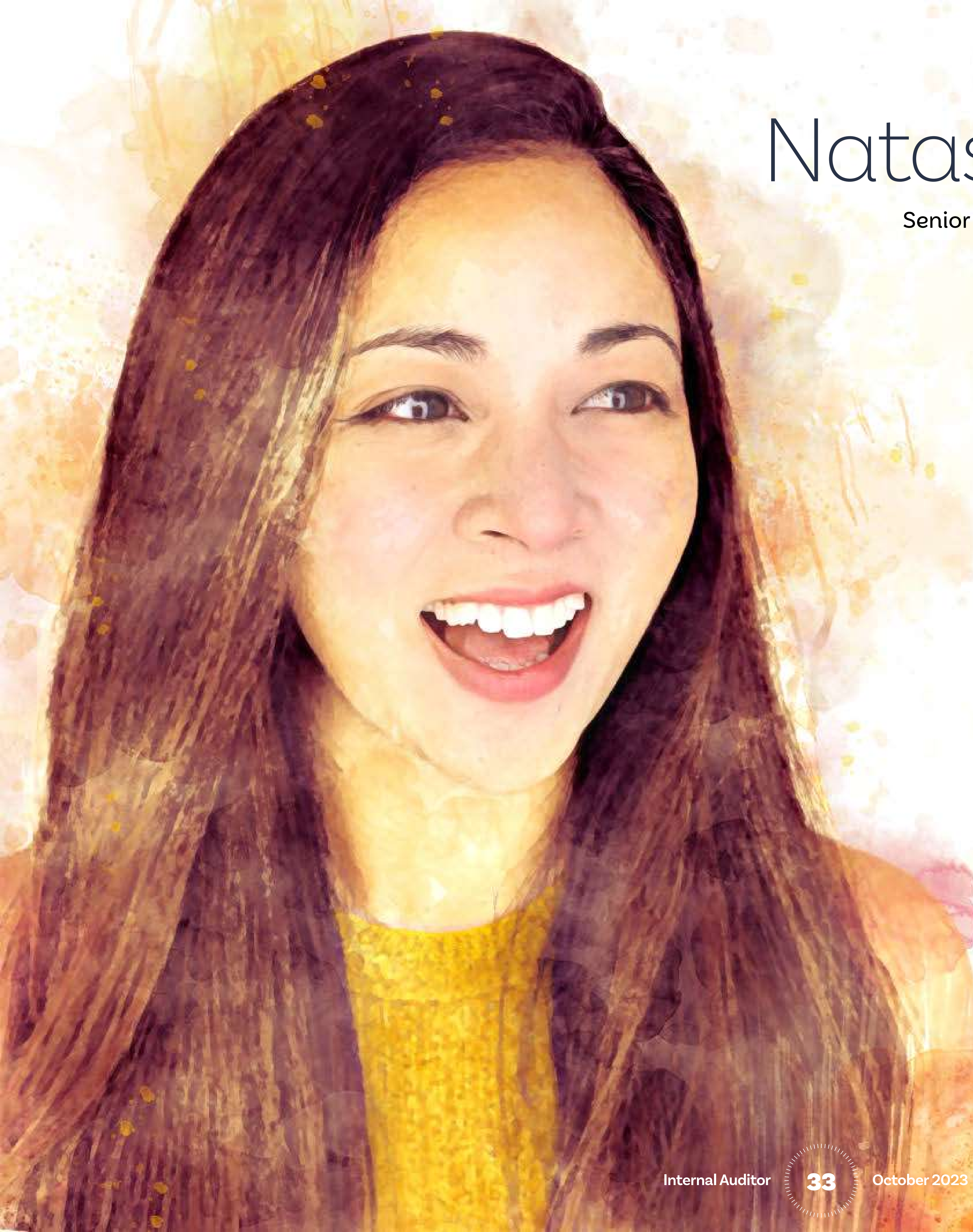
Emerging **Leaders**

A vanguard of visionaries is helping define the future of internal auditing in an era of technological transformation. **Emily Primeaux**

In the ever-shifting technology landscape, where generative AI and expansive language models have taken center stage, a bright horizon emerges for the internal audit profession. This year's 15 exceptional Emerging Leaders have not only embraced the winds of change but harnessed them to steer the course of innovation. Data analytics is a mainstay of their practice and their pragmatic approach to incorporating new tools in their operations showcases their adaptability and versatility. These Emerging Leaders embody a resounding beacon of optimism and are a testament to the internal audit profession's boundless potential for harnessing innovation, collaboration, and vision.

Natasha Fernandez

Senior Risk Advisor / Uber Technologies Inc. / San Francisco



Natasha Fernandez's internal audit journey began in college when her internal audit professor invited practitioners to share their real-world experiences with students. During a networking reception afterward, Fernandez received a business card from a vice president at Singapore Airlines. When she graduated a year later, she pulled out that business card, reached out to him, and landed a job.

Now at Uber, Fernandez leads thought leadership projects and tackles challenging reviews that require creativity, flexibility, deep dives into niche areas, and strong relationships with stakeholders. She says the most validating feedback comes from proactive requests from stakeholders to collaborate with internal audit on high-risk areas.

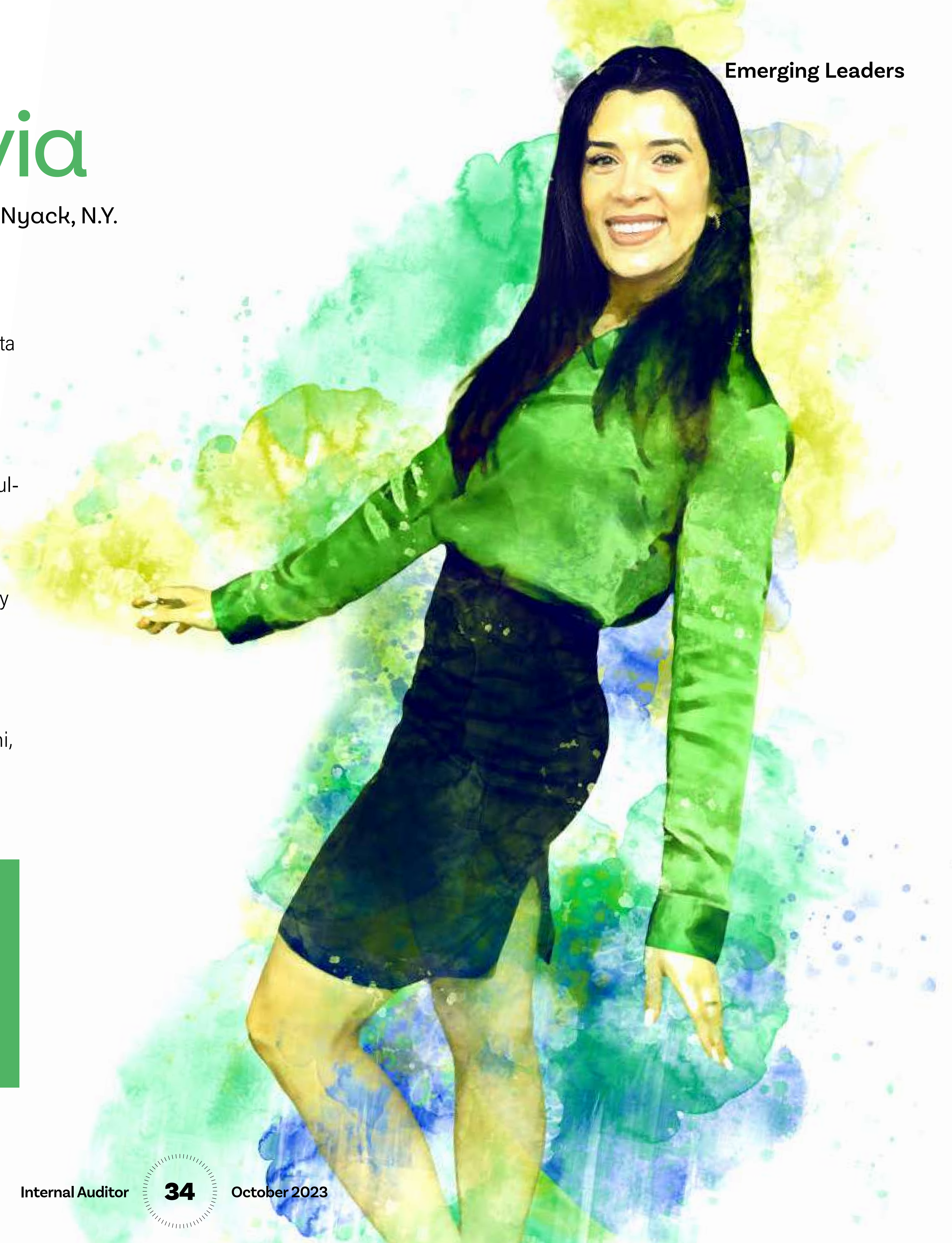
Recently, her team reported on critical business risks that aligned with the audit committee's concerns and goals. "It was a truly satisfying and proud moment to produce a piece of work that was not just reflective of our team but also the hours of collaboration and input provided by more than 100 stakeholders across the business," she says.

This is typical of the excellence, motivation, and "grit" Fernandez shows, says Uber CAE Dominique Vincenti. "Natasha has won numerous awards for her ability to deliver quality work consistently, to be curious, and to find critical problem areas that management cares to know about and address," Vincenti says.

Age: 30
Certifications: CIA, CRMA, CA (Singapore)
Chapter: IIA–San Jose
University: Singapore Management University
Interests: Watercolor painting, crafting gifts and cards, hiking, international travel.
Causes: Local food banks.

Shanna **Saravia**

Internal Audit Manager / Warner Bros. Discovery / Nyack, N.Y.



When Shanna Saravia was in middle school, her homeroom teacher chose her to help with bookkeeping for money the class received for its "Pizza Wednesday" lunch days. "One day she told me, 'With your attention to detail, I can see you becoming an accountant,'" Saravia says. "That comment stuck with me."

Although she studied public accounting in college, she now focuses her attention to detail on advancing data analytics and automation in the audit practice at Warner Bros. Discovery. Lauded by co-workers for her innovative mindset, Saravia's goal is to build a dedicated data analytics team with the skills and expertise to promote efficiencies and effectiveness.

One of Saravia's recent projects involved building multiple analytics dashboards to show spending trends for a newly merged organization. "While some people shy away from new technologies and tools, Shanna is the first to volunteer to learn and tell us how we can build them into our roadmap," says Jen Fortini, senior director, internal audit at Warner Bros. Discovery.

Age: 29
Certifications: CPA
Chapter: IIA–Washington D.C.
University: Pace University
Interests: Exercise and international travel.
Causes: Animal care and participating in town cleanups.

Age: 29

Certifications: CIA

Chapter: IIA International member

University: Singapore Management University

Interests: Kite-flying, wine, coffee, and leathercraft.

Causes: LGBTQ+ equality and supporting low-income communities.

Ying Ho **Lee**

Assistant Vice President and Audit Supervisor
Bank of America / Singapore

Ying Ho Lee says curiosity fuels his desire to continuously learn, grow, and approach challenges with an open mind. He says he is invigorated by the dynamic nature of internal auditing within the financial sector, where the constantly shifting regulatory landscape and emerging trends provide an exciting backdrop for professional development. Providing valuable assurance and insights to stakeholders fuels his passion for the critical role internal audit plays in effective corporate governance.

At Bank of America, Lee is entrusted with leading multifaceted internal audit projects spanning diverse domains such as corporate banking and human resources. He says his proudest achievement, however, has been mentoring four internal audit professionals in a global data analytics training initiative. "Witnessing their adept use of data analytics in audit work and triumphant completion of data analytics certifications gives me a sense of fulfillment," he says. "This mentorship has allowed me to make a tangible and transformative impact by guiding and empowering others."

Lee's mentorship doesn't stop in the office. He provides guidance for at-risk youth in his community. "Ying Ho is passionate about LGBTQ+ equality and helping those in need, which is in line with the bank's commitment to drive economic and social progress," says Li Ca Goh, audit director at Bank of America.

THE POWER TO

celebrate success

Bank of America is proud to support The Institute of Internal Auditors. Congratulations to Ying Ho Lee on your well-deserved recognition.

BANK OF AMERICA

Brooke Lobdell

Internal Auditor, Corporate & Data Analytics
Nutrien / Saskatoon, Saskatchewan

Brooke Lobdell says she has always had a keen interest in data analytics and automation, and after beginning her career at Ernst & Young, she wanted to find a role where she could develop that proficiency. She found that opportunity at Nutrien, where she maintains the current automation platforms and coordinates with diverse teams to improve business functions.

"I am passionate about working with teams to detect bottlenecks, identify improvements, and create innovative solutions," Lobdell says. "Being able to bring data-driven solutions to the teams I work with excites me; it allows the teams to garner deeper insights from their data and lets me demonstrate the value internal audit brings."

She leveraged this innovative mind to develop her first SQL script. The script was designed to detect conflicts of interest using data from multiple platforms, comparing the results to conflicts that had already been disclosed. Despite its complexity, she says the research to find the appropriate formulas and automate the analysis of new data was rewarding.

"Brooke is responsible for looking after more than 25 active robots and has written seven complete scripts while balancing her responsibilities in audit engagements," says Tony Gee, corporate auditor at Nutrien.

Age: 27
Certifications: CIA, CPA
Chapter: IIA–Saskatchewan, board member
University: University of Saskatchewan
Interests: Baking, yoga, and pilates.
Causes: Community gardens, the food bank, the Saskatchewan Children's Festival, and DEI groups within Nutrien.

Joshua **Castille**

Manager, Risk Advisory Services / Weaver / Houston

When Joshua Castille isn't busy managing client relationships or developing and overseeing internal audit plans, he's likely helping individuals entering the workforce discover career opportunities within internal auditing.

"I have had great role models who have committed time to my development, fostering truly respectable relationships that have been critical in getting me to where I am today," says Castille, who was introduced to the profession through IIA Centers of Internal Audit Excellence at Louisiana State University and The University of Texas–Dallas. "I want to be a leader and coach for others, paying it forward and fostering an environment where questions, development, and involvement are not only welcomed, but encouraged."

And Castille's commitment to helping others is evident in the praise he receives from his team. "I am always thrilled to be on a certain client or project with Josh because I know I will be able to learn so much from working with him," says Hannah Reddecliff, a risk advisory associate at Weaver.

Castille has twice received Weaver's Risk Advisory Professional Excellence award, which is based on nominations from leadership and awarded to one member of the Risk Advisory Services team each year.

Age: 29

Certifications: CIA, CPA

Chapter: IIA–Houston, member of the annual conference committee.

University: Louisiana State University and The University of Texas–Dallas

Interests: Learning to play drums, golfing, bowling, spending time with his two rescue dogs.

Causes: Education and local food charities such as Kids Meals on Wheels and the Houston Food Bank.

Alex Heisler

Senior Auditor / Gate City Bank / Fargo, N.D.

Alex Heisler believes that giving back to the community is just as important as his day-to-day professional responsibilities because it builds relationships with community members and teaches life skills — such as generosity, selflessness, and empathy — that he can use throughout his career. "In Fargo, there are many families that rely on the services of food pantries," he says. "Throughout the year and especially during the holidays, our internal audit team enjoys serving together to help provide families in need with groceries and everyday essentials."

In his current role, Heisler manages a portfolio of internal audit engagements and assists the CAE in annual audit planning, risk assessment, and relationship management activities. His career goal is to lead an audit team that promotes excitement for the profession and fosters innovation to add value to the organization.

"Alex reinvented our approach to auditing our retail branches," says Tammy Valvo, CAE at Gate City Bank. Heisler built a risk assessment process to gather and analyze data to develop a multi-year coverage plan for the bank's 43 retail branches. "Alex demonstrated innovative thinking in his approach to data analytics by helping colleagues think through tests and minimizing false positives," Valvo adds.

Age: 28

Certifications: CIA, CRMA

Chapter: IIA–Red River Valley, Programming Officer, Vice President/President Elect

University: North Dakota State University

Interests: Golf, the lakes, hunting, downhill skiing, and travel.

Causes: Food pantries and supporting families in need.

Areeba **Hassan**

Manager, Enterprise Functions Audit / Scotiabank / Toronto

At the age of seven, Areeba Hassan noticed her father reading a book with "CIA" and a magnifying glass on the cover. She mistook those letters for the U.S. Central Intelligence Agency but later learned they represented Certified Internal Auditor. She has associated a "certain coolness" with internal auditing ever since.

Now, Hassan says she strives to provide excellence in her internal audit work, including understanding risks and objectives and their impact on the organization while maintaining the highest standard of ethics. She says she has cultivated an ability to take anything with complexity and uncertainty, evaluate potential risks, and ask the right questions to break down the issue. "I credit it to being curious about the business and open to new challenges," she says.

For example, Hassan recently recommended adding automation and process mapping to enhance senior management-level reporting for the human resources function's audit team. "Always demonstrating curiosity and eagerness to learn new skills, Areeba has taken on the responsibility to automate certain processes for the unit," says Carla Vargas, director of enterprise functions audit at Scotiabank.

Age: 29
Certifications: CIA, CRMA, CMA
Chapter: IIA–Washington D.C., Vice President of Communications
University: Athabasca University
Interests: Learning new languages (currently French, Urdu, and Punjabi), running, philosophy, psychology, and art.
Causes: Healthcare.

Monica **Vulich**

Audit Data Analyst / Yum! Brands / Winston-Salem, N.C.

Monica Vulich was introduced to the internal audit profession when she joined her university's Center for Internal Audit Excellence program as a teaching assistant and officer. Now she supports her internal audit team with dashboards for reports and audit statutes.

A former data engineering intern, Vulich recently programmed a data connection between Yum! Brands' audit software and its business intelligence platform, which allowed auditors to create and update reports in real time throughout the audit cycle. "What excites me about my work is getting to work on new challenges and with different types of data," she says.

Peers recognize Vulich's innovative thinking and speaking prowess. In October 2022, she spoke on data analytics at the annual IIA–Dallas Super Conference and in February she spoke on the same topic at a continuing professional education lunch for the IIA–Louisville, Ky. chapter.

"Monica is a natural leader who excels at building collaborative environments that allow for strong team building," says Joseph Mauriello, director for the Center for Internal Audit Excellence at UT Dallas. "Her thought leadership and contributions to the conference resulted in recognition from her peers."

Age: 26

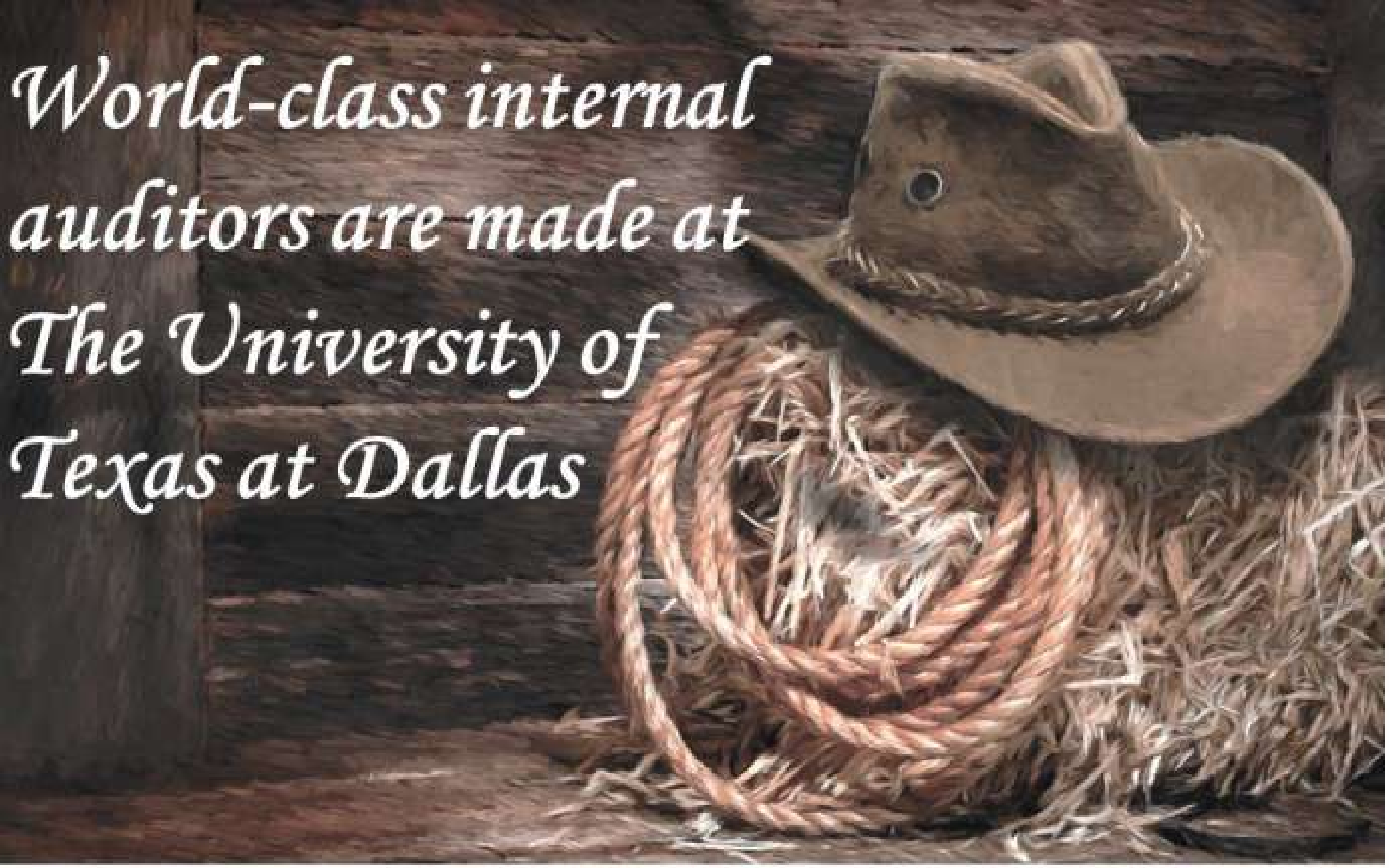
Certifications: CIA, CISA

Interests: Exercising, weekend trips, the restaurant industry, and football.

Chapter: IIA–Raleigh-Durham

University: University of Texas–Dallas

Causes: North Texas Food Bank, and racing events such as Spartan and the Multiple Sclerosis Mud Run.



The Center for Internal Auditing Excellence (IAEP) at The University of Texas at Dallas congratulates **Monica Vulich** for her recognition as an emerging leader in the internal auditing profession.

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For more information about meeting the next generation of internal auditors, please reach out to Center Director Joseph Mauriello, PhD, CIA.

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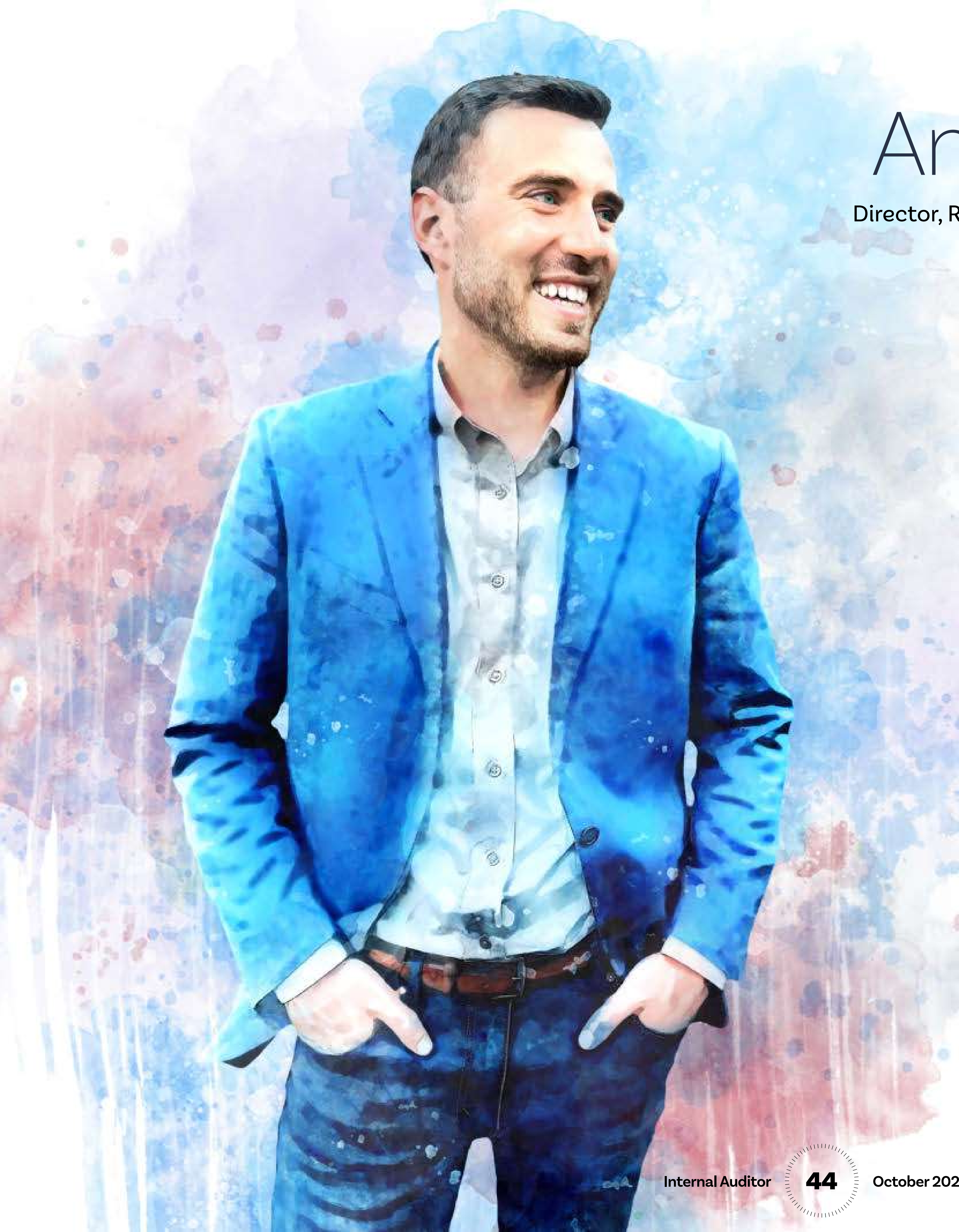


Andrew Sizemore

Director, Risk & Controls / Clark Schaefer Consulting / Cincinnati

Andrew Sizemore's goals are driven by his desire to help others. "My youngest brother has Down Syndrome, so I am passionate about helping serve individuals with special needs," he says. In addition, he mentors children in Cincinnati who struggle with homelessness. "Giving back to the community is an important part of my faith and personal values," he explains.

Sizemore began his career at a public accounting firm performing financial statement and System and Organizational Controls (SOC) audits. In his current role, he oversees the performance and sales of internal audit, risk assessment, SOC reporting, and testing services for Sarbanes-Oxley, the Japanese Financial Instruments and Exchange Law, and the insurance industry's Model Audit Rule.

Sizemore has led the internal audit division through organizational changes such as a company merger and system implementations, says DeAnna Bird, chief operating officer/chief administrative officer at Clark Schaefer Consulting. "Andrew actively promotes a culture of continuous learning within his team by encouraging certifications, attending relevant training programs, and participating in professional forums," she says.

Sizemore says he is especially proud of recently passing the CIA exam. He says he would like to serve on the board of a nonprofit organization and work with colleges to help inspire and recruit future auditors. He and his fiancé, Emily, plan to marry in 2024.

Age: 27
Certifications: CIA, CPA, CISA
Chapter: IIA–Cincinnati
University: Xavier University
Interests: Fishing, camping, hiking, and sports.
Causes: Special needs and child homelessness.

Brent Logan

Senior–Internal Audit & Audit Analytics
Alliance for Sustainable Energy LLC / Golden, Colo.

In college, Brent Logan was advised that learning accounting and auditing would equip him with universally applicable skills that would open opportunities throughout his career. Following this advice led him to internal auditing and his current role at the Alliance for Sustainable Energy, which is the operating contractor for the National Renewable Energy Laboratory (NREL).

Logan manages a spectrum of responsibilities, including overseeing and providing audit and advisory services, maturing the use of data analytics, and leading the configuration and optimization of NREL's audit management software. "My role in internal audit provides me the opportunity to collaborate with driven individuals who are passionate about the NREL vision of a clean energy future," he says. "By providing meaningful assurance and recommendations, I contribute to the vision by helping management improve operations, risk management, and control activities."

Logan currently leads a comprehensive audit engagement — comprising all phases of the capital project life cycle — of management's stewardship of infrastructure projects funded by the U.S. Inflation Reduction Act of 2022. Stakeholders appreciate his insight and feedback in helping them manage risks.

Colleagues have noticed Logan's good work. "Brent works on complex and sensitive internal audit and advisory engagements and has demonstrated his ability to use his business acumen and leadership skills to produce high-quality work products with impactful results," says Brent Olson, director of internal audit at NREL.

Age: 29

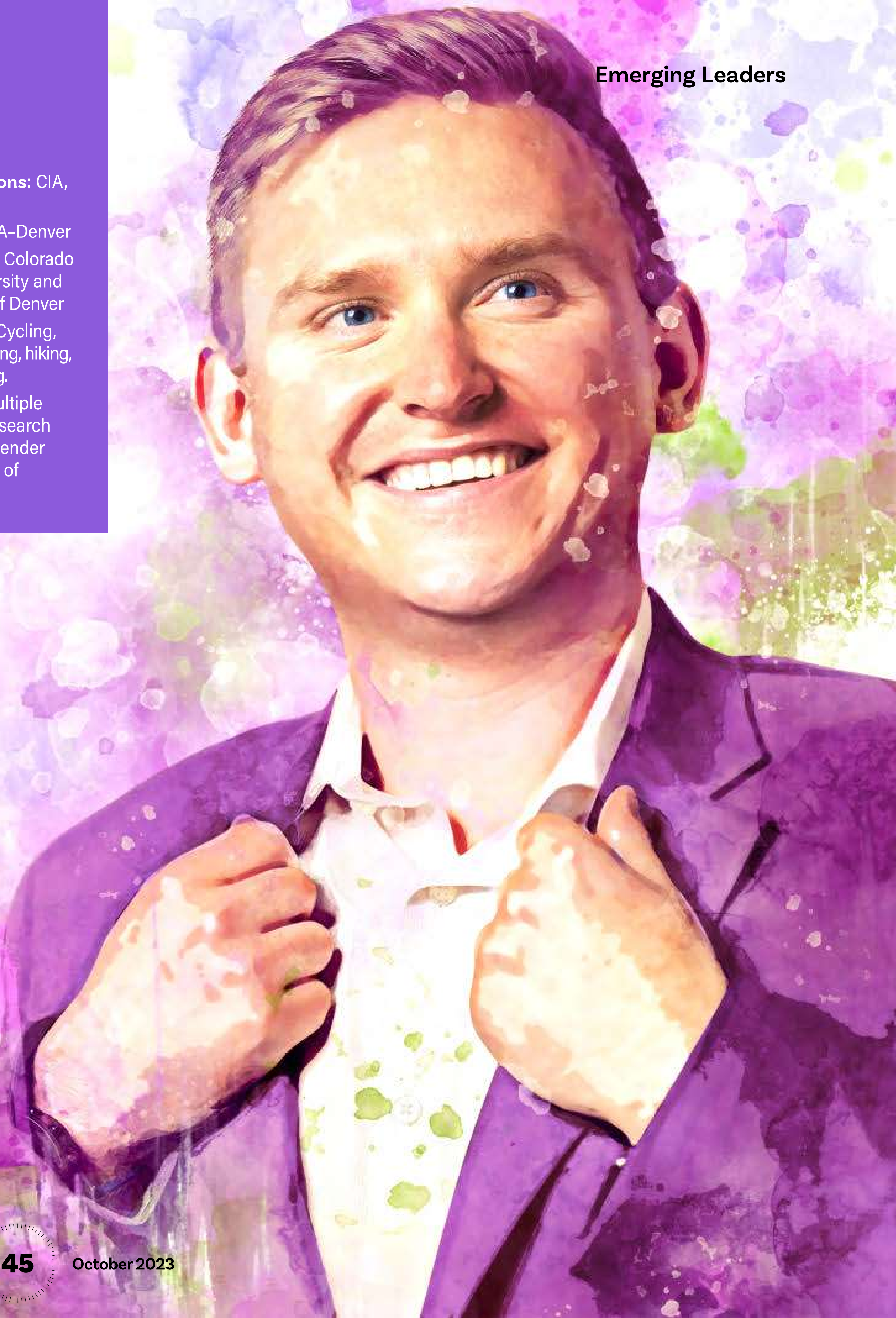
Certifications: CIA, CPA, CFE

Chapter: IIA–Denver

University: Colorado State University and University of Denver

Interests: Cycling, skiing, running, hiking, and camping.

Causes: Multiple Sclerosis research and the Lavender Association of Colorado.



Jason Gilley

Senior Manager, Governance, Risk & Control Advisory
Ontario Lottery and Gaming Corp. / Toronto

Age: 27
Certifications: CPA
Chapter: IIA–Toronto
University: Ontario Tech University
Interests: Weightlifting, running, and spending time with family.
Causes: Men's health and local food banks.

Jason Gilley wants to look back on his career and be able to say he had a positive impact on the organizations, people, and communities with which he worked. Each workday, he says he's excited to learn from diverse and talented professionals who open his mind to new ways of working and challenge him to think innovatively.

Gilley reached this place of career optimism thanks to guidance from college mentors who introduced him to the audit profession and the chance to perform purpose-driven work. One of his proudest accomplishments is working to improve employee engagement, collaboration, inclusiveness, and professional development within his organization's internal audit function. "I hosted focus groups to garner feedback and develop key initiatives to implement in each of these areas," he says. "Even a small contribution that generates a feeling of empowerment and inclusion among the team is a success to me."

That contribution makes Gilley well-respected inside and outside the workplace, says Kyra Li, a 2020 Emerging Leader and director of Governance, Risk, and Control Advisory at the Ontario Lottery & Gaming Corp. "Internally, he has spearheaded initiatives to improve the employee experience and create a fun environment that attracts talented individuals."

Externally, Gilley is passionate about working with his community, including raising funds for Crohn's and Colitis Canada research.

Aimee Bhakthavachalam

Manager, Internal Audit & Financial Advisory
Protiviti / Houston

Aimee Bhakthavachalam says in her work she often sees a diverse set of problems to solve. She leads an outsourced internal audit team assisting in Sarbanes-Oxley compliance and is excited to contribute to her clients' efficiency, safety, and trustworthiness.

Last year Bhakthavachalam worked with a client who faced an issue with a control gap in payments, and her team performed a gap analysis. She came up with an idea to create a visual to show the relationships between the various spreadsheets that were used in the process. By showing the relationship between data more easily, the visual helped identify one of the root causes that the client was facing. "My teams were supportive and provided great feedback that allowed me to build the final versions of the visual," she says.

Such problem-solving is typical of Bhakthavachalam, who recently was among the winners of Protiviti's Python Hackathon. "Aimee goes the extra mile to deliver on Protiviti's commitments to clients and their team members, always finding ways to innovate and work smarter," says Andrew Struthers-Kennedy, managing director and global practice lead, Internal Audit & Financial Advisory at Protiviti.

Age: 30
Certifications: CIA, CPA
Chapter: IIA–Houston
University: University of Houston
Interests: Photography and tennis.
Causes: Mentorship of university students and young professionals.

Jada Pierre

Senior Internal Auditor / TIAA / Charlotte, N.C.

Jada Pierre recounts a time last year when she was given less than 48 hours to prepare a mid-year presentation. "I was nervous as this was the first time I had to present solo to my entire department," she says. "It took me out of my comfort zone and proved to others — and mainly myself — that I can execute quality work under pressure."

As the auditor in charge (AIC) at TIAA, Pierre is responsible for drafting all planning documents, planning walk-through meetings with clients, coordinating between the audit team and its clients, managing people, and drafting audit reports. Currently, as the AIC, Pierre is working on a confidential review, collaborating closely with her director and managing a small team. She is responsible for reviewing work, drafting the final report, and creating presentations for the chief financial officer. "Being a first-year senior, this is a huge opportunity for me as I get the chance to step into the role of a manager, which is the next step in my professional journey," she says.

Goal-oriented, Pierre is an advocate of diversity, equity, and inclusion and takes on leadership roles in her company's team-building events and community service initiatives. "Jada is particularly passionate about fighting hunger and supporting access to nutritional meals for those living in food deserts and helping to organize meal kit and snack-packing events," says Angie Jin, senior director of internal audit at TIAA.

Age: 25

Chapter: IIA–Charlotte

University: Southern New Hampshire University and the College of Charleston

Interests: Anime, travel, dine-in movie theaters, party planning, interior design, and her dog, Koda.

Causes: DEI initiatives and fighting hunger.

Alina Shynkar

Assistant Project Manager / ADM
Hamburg, Germany

Alina Shynkar moved from Ukraine to Hungary on her own when she was 17 years old to study at a business school in Budapest and then started her career at a Fortune 500 company without speaking the local country's language.

"I am eager to learn, grow, and develop," Shynkar explains. "I am proactive in seeking opportunities for skill-building, taking on challenges, and expanding my knowledge base, and I'm happy to step outside of my comfort zone."

Now living and working in Germany, Shynkar is a member of ADM's internal audit team for Europe, the Middle East, and Africa. "Alina leads internal workshops, lives ethical values, and is an example of being inclusive to a diverse team," says Christian Gutzeit, senior audit manager at ADM.

In 2022, Shynkar introduced expanded data analytics into regional audits and promoted an agile approach throughout the life cycle of projects. She says it was an opportunity to go above and beyond by delivering results.

Age: 29
Certifications: CA
Chapter: IIA–Central Illinois International Member
University: International Business School of Budapest and Maastricht University

Interests: Hiking and escape rooms.
Causes: Ladies' Circle International (a social networking organization for young women) and supporting Ukraine and Ukrainian refugees.

ADM congratulates Alina Shynkar for being named one of the Internal Auditor's Emerging Leaders.

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ADM

Hasan **Aliyev**

Group Internal Audit Manager / Agrotrade Supply Group / Baku, Azerbaijan

Hasan Aliyev is fascinated with data analysis, risk management, internal control, and governance, fueling his desire to engage in multifaceted business processes. He pursues these interests through strategic activities such as spearheading group risk assessments, crafting audit plans, and presenting findings to audit committees and supervisory boards.

Aliyev oversees audits for 10 subsidiary manufacturing and agriculture companies, channeling his insights to help elevate operational efficiency and enhance risk profiles. He also lends his expertise to the audit committees of two companies.

Recently, Aliyev led a meticulous risk assessment and audit planning endeavor for two critical audit engagements by interviewing key stakeholders, analyzing business processes and internal controls, and pinpointing ways to overcome strategic barriers. Aliyev provided valuable insights to management, "underscoring the proactive role of internal audit in risk mitigation, fortifying internal controls, and fostering governance

Age: 28

Certifications: CIA, CRMA, ACCA, CFE, FMVA

Chapter: IIA–Azerbaijan

University: Azerbaijan State University of Economics

Interests: Playing football and tennis, watching documentaries, and reading economic, historical, and classical literature.

Causes: Education, charity runs, and environmental clean-up campaigns.

excellence," he says. "This accomplishment stands as a pivotal milestone in my career."

Beyond his professional domain, Aliyev offers his expertise through educational workshops and mentoring individuals aspiring to earn the CIA and CRMA designations. His advocacy extends to nurturing the growth of IIA–Azerbaijan, helping more than 15 new members join the organization.

"Hasan's commitment to promoting the importance of internal auditing and building strong professional networks exemplifies his dedication to advancing the profession and supporting his peers," says IIA–Azerbaijan President Aziz Fataliyev.

Emily Primeaux is the writing manager at Dragonfly Editorial and former associate editor at *Fraud Magazine*. She is based in South Florida.

Meet the Judges

This year's judges represent global leaders in the internal audit profession, including members of The IIA's Global Board of Directors and Guidance Council and North American Board of Directors and Content Advisory Council. The judges considered each candidate in the areas of business acumen/leadership, innovative thinking, service to the profession, and community service.

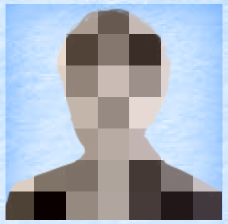
Stefano Comotti, CIA, CRMA
CAE, Kering Group, Paris
Member, Global Board

Michael Lynn, CIA, CRMA, CPA
Principal, Argo LLC, New York / Vice Chairman, Content & Prof. Development, N.A. Board; Board Liaison, N.A. Content Advisory Council

David Helberg, CIA, CRMA
Director of Internal Audit, Corporate Ethics and Privacy Officer, Cameco Corp., Saskatoon, Saskatchewan
Member, North American Board

Stacey Schabel, CIA, CPA
Senior Vice President and CAE, Jackson Financial Inc., Lansing, Mich.
Member, Global and North American Boards

Katherine Homer, CIA, CRMA
Vice President, Independent Assurance Services, Bose Corp., Natick, Mass.
Member, N.A. Content Advisory Council



Tania Stegemann, CIA, CRMA, CCSA
Group Manager, Internal Audit, Newcrest Mining Ltd., Melbourne, Australia
Chair, Global Guidance Council

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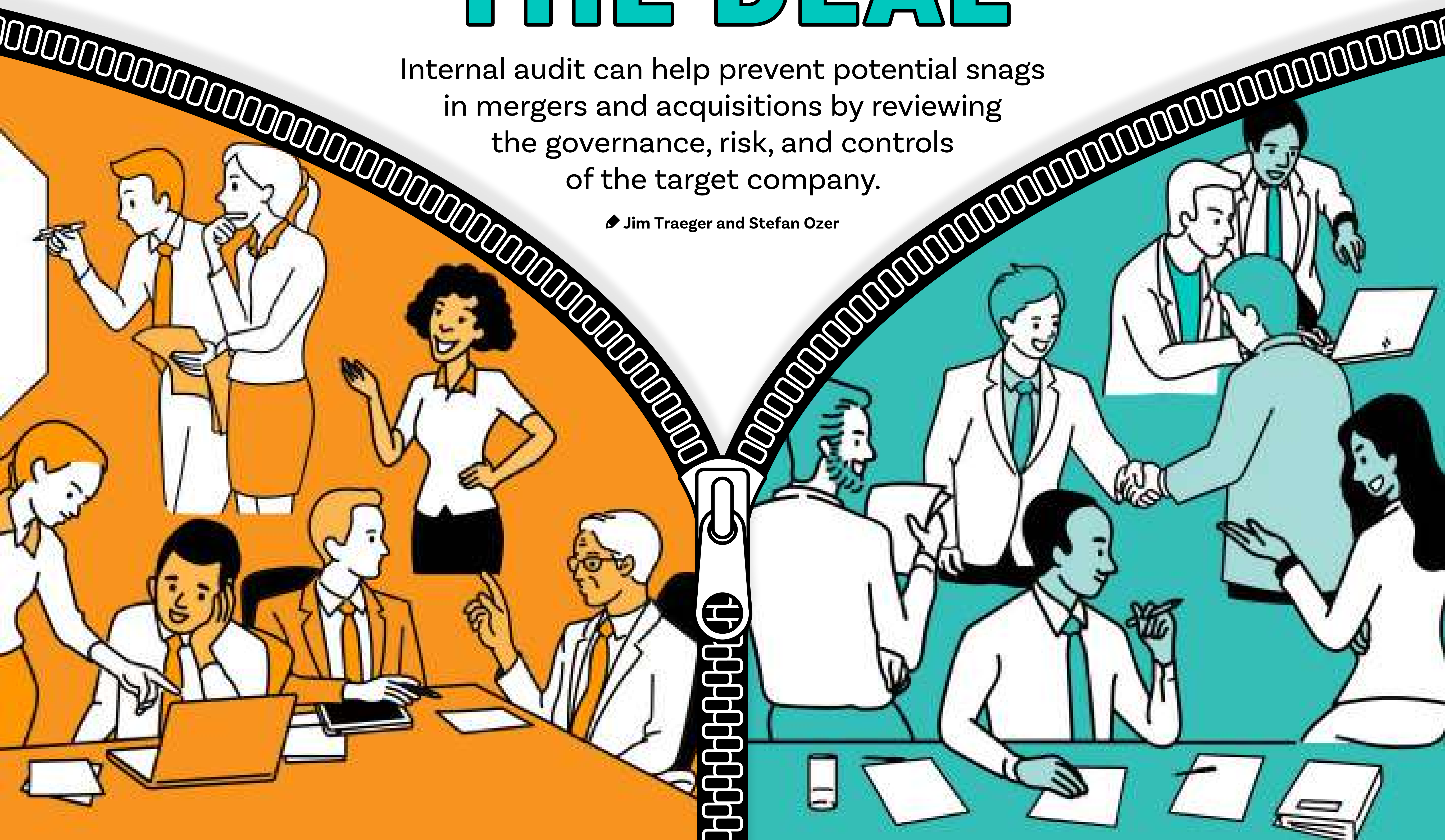
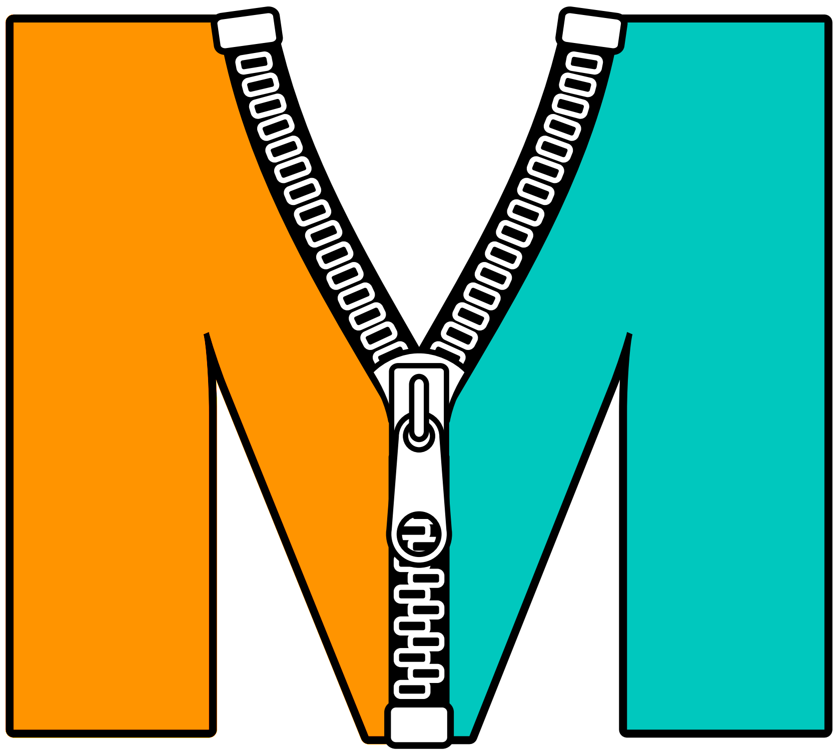
SEALING THE DEAL

Internal audit can help prevent potential snags in mergers and acquisitions by reviewing the governance, risk, and controls of the target company.

✎ Jim Traeger and Stefan Ozer





Mergers and acquisitions (M&A) are material milestones that often require substantial financial and operational resources. Given the importance of these transactions, companies can spend much thought and effort on the financial side of the deal, performing due-diligence analyses, identifying synergies, and planning for system integration. What may be overlooked, however, is the importance of the internal controls and processes required to assess, record, and integrate the acquired company into the overall financial structure. Risks involving its culture and organizational structure may also be missed.

Internal audit can help management understand the risks and related controls needed within both organizations to ensure that not only is a good business decision being made, but also that the financial information is complete and accurate throughout the M&A life cycle.

THE M&A LIFE CYCLE

The M&A life cycle comprises the pre-deal diligence and financial assessment, the valuation work and purchase price allocation at acquisition date, and the post-deal integration efforts. Internal audit plays an integral part in the execution at each stage.

Pre-deal diligence and financial assessment. An important, yet potentially neglected, component of any M&A transaction is the assessment of the target company's governance, risk, and controls. Understanding how a company is run and how the financial data flows into key reports helps determine how reliable the financial data is and helps substantiate other information uncovered in the pre-deal diligence. This becomes even more important, depending on the nature of the target company's operations and history of its financial reporting requirements.

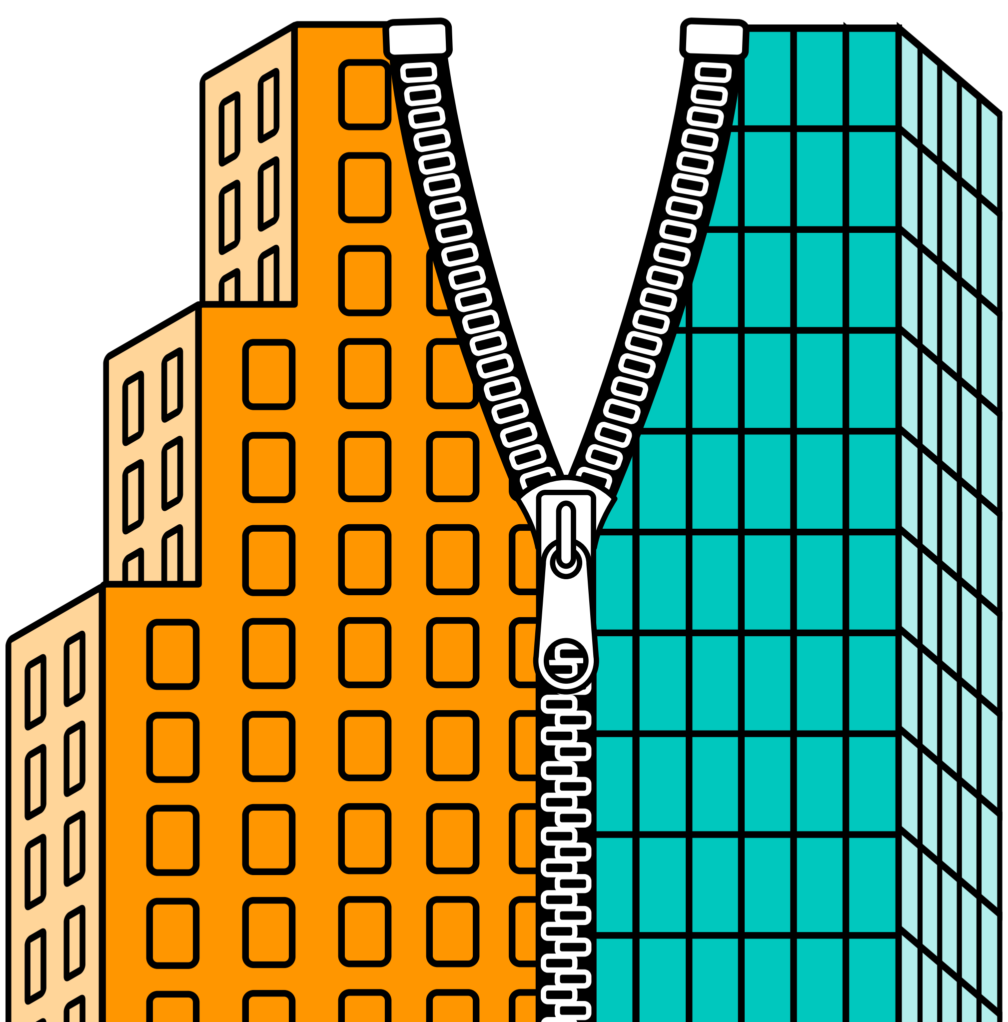
For example, the level of effort and risk may increase if the target is a privately held company that has not previously been audited, as management may not have a formal, documented understanding of the flow of transactions. This also may be the case for a target that is a carve-out of a larger enterprise and has not been subject to its own internal controls or financial reporting framework.

The state of the internal controls and processes at the target may even impact the purchase price the acquiror is willing to pay. If a robust governance, risk, and controls culture was not a top priority at the target company, the acquiror may decide to discount the deal price, based on the perceived level of increased risk — or include other deal terms, such as working capital adjustments or performance contingencies.

Increased risk levels are not limited to private company targets. A deal that includes a smaller public company or part of a public company can also present challenges, and the acquiring company should have a thorough understanding of the company's internal controls and processes as part of the diligence process.

Because of their familiarity with all aspects of the organization and its risks and controls, internal auditors are well-suited to provide management with support and insight during the pre-deal diligence process in areas such as:

- Performing a financial statement and fraud risk assessment of the target company.
- Meeting with the previous auditor, if applicable, to understand any challenges incurred during the target's legacy audits and obtain related communications to management on control findings.
- Analyzing the target's governance, risk, and controls related to business processes, technology, cybersecurity, and sustainability and determining the work required in the diligence process. Less mature or formalized controls may require more scrutiny.



- Reviewing challenging areas, such as the financial closing and reporting, significant management estimates, and third-party information.
- Understanding the completeness and accuracy of the information provided by the target company and whether additional scrutiny is required.

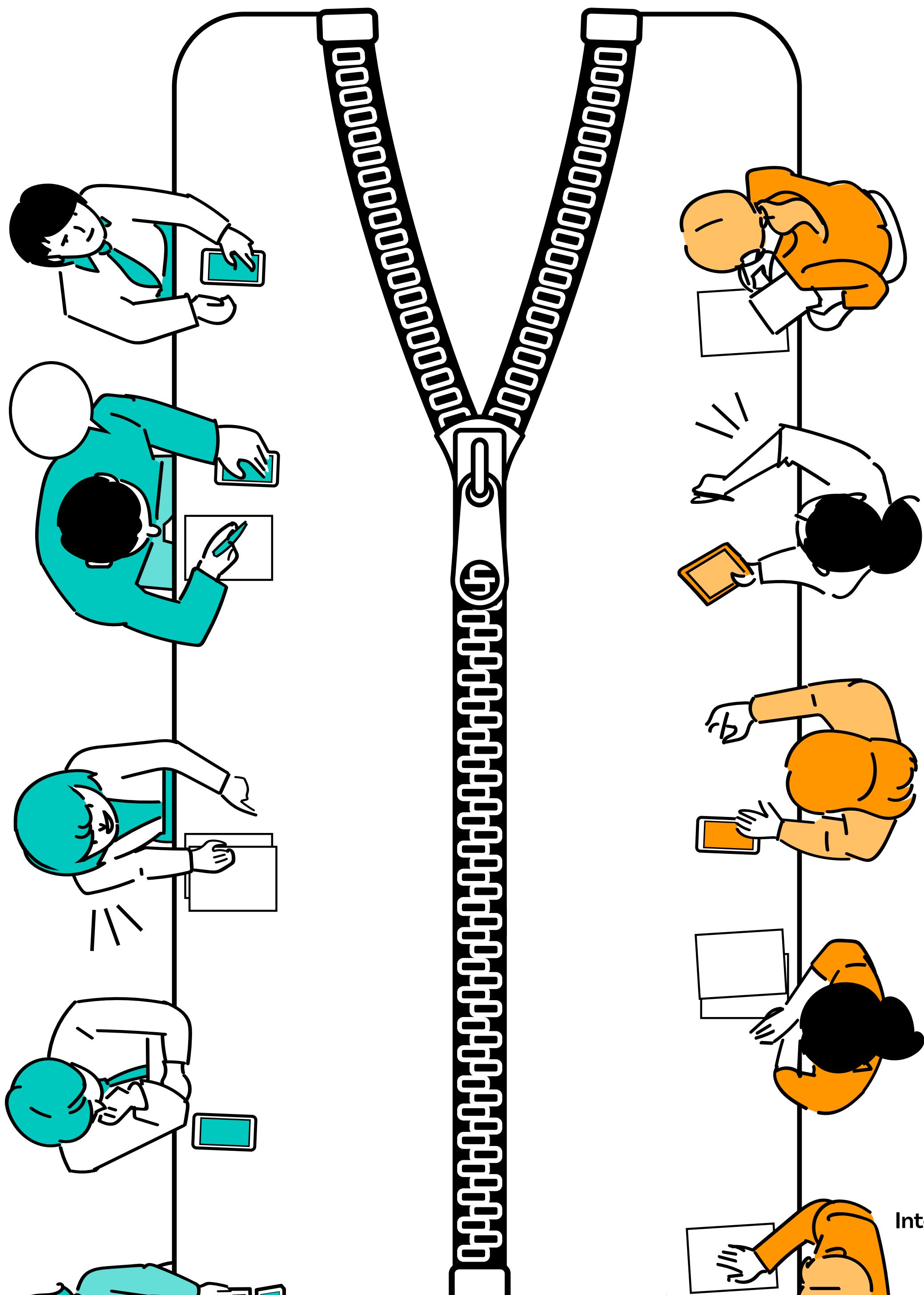
Failure to consider the governance, risk, and controls in the diligence process can lead to unforeseen challenges and costs. The use of incorrect financial data could result in restatements, internal control findings and related errors, and the potential failure of the deal.

Valuation work and purchase price allocation. Given the infrequency of M&A activity, companies may not have documented controls to address risks relative to a significant transaction. Also, the scope of necessary controls may vary from transaction to transaction. Internal auditors can advise management on risks associated with the transaction, including the extent of work needing to be performed to ensure the amounts recorded in purchase accounting are complete and accurate. Auditors also can assess the impact the acquisition could have on the acquiror's internal control framework and compliance efforts, such as the U.S. Sarbanes-Oxley Act of 2002. Internal audit should keep in mind that controls related to purchase accounting, such as the recording and disclosing of the opening balance sheet, are part of the acquiror's control framework and not subject to regulatory exceptions during the year of acquisition.

The organization should consider the procedures required to facilitate the accurate recording and disclosure of the transaction. For example, management may consider it prudent to perform a combination of substantive and internal control-related procedures to test and validate the fair value of the assets acquired, including the hiring of any valuation specialists, depending on the nature and complexity of the transaction. Any of the procedures performed to review and approve the amounts recorded should be documented — the extent of which is based on the risk associated with each assertion.

Examples of controls an organization may put in place during an acquisition include:

- Board approval and review of pre-deal diligence information.
- Validation of working capital/consideration paid in the deal, including evaluation of contingent consideration.
- Budgeting and forecasting controls used in the valuation of intangibles, with specific procedures over the review and approval of the significant assumptions that drive the relevant values, such as growth and discount rates.
- Controls over the valuation specialists, including consideration of their qualifications,



assumptions used, work results, and overall management.

- Identification of the acquired assets and liabilities and consideration of the accounting implication of the overall terms of the deal (i.e., business combination or asset acquisition), including working capital adjustments and complex instruments (equity, debt, compensation, etc.).
- Preparation and review of related accounting journal entries and disclosures in the financial statements.
- Inventory counts (including third-party confirmation) and individual valuation assumptions, including margin, cost to sell, and oversight of any third-party valuation firms used in the assessment.
- Property, plant, and equipment physical verification, as well as fair value assumptions.

Robust documentation of management's determination of the fair value of the acquisition and purchase price allocation may result in several discrete control steps that should be considered, based on significance. Internal audit can assist management by validating the completeness of the framework and ensuring procedures are adequately documented so that management can take credit for the controls in place mitigating any material risks.

Documentation should include the details of what was reviewed, the source of the information used in the control, and what the conclusion was. Including documentation such as "We reviewed all unusual transactions" would not suffice as valid evidence of the execution of the controls.

Post-deal integration efforts. After the successful close of an acquisition, companies have an opportunity to take a fresh look at their governance, risk, and controls program. Building out an integration roadmap that emphasizes efficiency, technology, and automation opportunities can encourage growth and collaboration for the combined organization. Internal audit can help promote collaboration across key stakeholders and establish a quality future-focused compliance program.

To improve the combined organization's governance, risk, and control environment, internal audit may look at efficiencies in several areas:

- Refreshing the risk assessment.
- Standardizing existing controls.
- Enhancing the operating model.
- Scaling controls for future M&A or organic growth opportunities.
- Reducing the cost of compliance through the implementation of common controls, common systems, and/or automated controls and by consolidating operations.
- Leveraging new technologies and automation to mitigate the risk of more manual processes.

A pitfall experienced by many companies is failing to develop an effective internal control and process integration roadmap. Companies that don't have a comprehensive integration plan can find themselves in a situation where they are simply adding the target's existing controls to their own, resulting in a controls landscape that is inefficient and potentially more expensive. For example, an acquiror with 150 controls in its Sarbanes-Oxley framework that acquires a company with 120 controls, presumably would not now have 270 controls that are relevant.

Management, in conjunction with internal audit, should evaluate the newly combined organization and its controls to identify synergies and opportunities for automation. Similarly, performing an updated risk assessment will allow management and internal audit to better understand the risks associated with the new organization and identify gaps and opportunities.

WEAVING IT ALL TOGETHER

As companies seek out opportunities for growth through a merger or acquisition, they have a unique opportunity to unlock additional synergies, increase efficiencies, and reduce costs by incorporating a thoughtful assessment of a target's governance, risk, and controls environment into the M&A life cycle. Internal audit can bring valuable insights to the table and significantly impact the effectiveness of the transaction. Organizations that thoughtfully weave process, risk, and internal controls optimization into their integration process can provide greater insights and additional value to their key stakeholders.

Jim Traeger is a partner in Accounting Advisory and Transaction Services in the Audit & Assurance services business of Deloitte & Touche LLP, based in Houston.

Stefan Ozer is a partner in Accounting Advisory and Transaction Services in the Audit & Assurance services business of Deloitte & Touche LLP, based in Charlotte, N.C.

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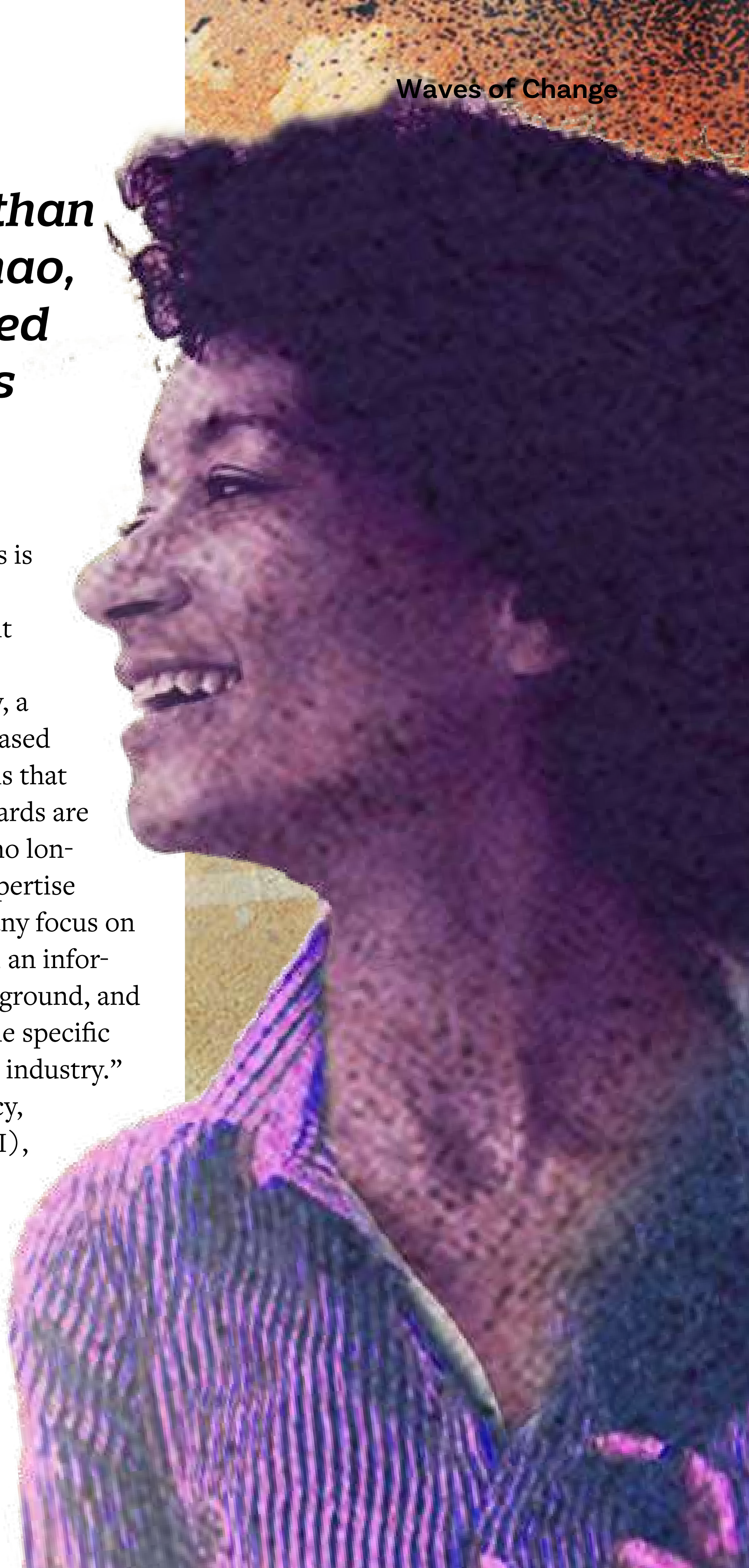
WAVES of CHANGE

Organizational governance has never been more important — or more challenging.

Jon Taber Tim Marrs



In a post-pandemic, digitally transformed world, the concept of governance stands out as more relevant than ever. Originating from the ancient Greek term kubernao, which means "to steer," governance today has evolved to represent the complex art of guiding organizations through modern challenges and stormy waters.

However, the current environment demands more than just navigation. Organizations need foresight and agility. Adaptability, transparency, and innovative leadership are critical to governance, as with ever-increasing challenges come more opportunities. Today's leaders must embody these principles to help determine whether their organizations survive and thrive while riding the waves of change.

In this context, internal audit's role is critical, acting as a guiding light for boards to effectively govern in this digital age with confidence.

The EVOLVING BOARD

In the last three years, boards, specifically audit committees, have experienced a significant increase in their roles and responsibilities. The Audit Committee Blueprint, released this year by the National Association of Corporate Directors and KPMG, highlights 10 essential areas of focus for audit committees going forward: financial reporting and expertise; risk oversight; environmental, social, and governance (ESG) risk and disclosures; finance function talent; audit quality; internal audit value; transparency; compliance and culture; critical alignments; and audit committee focus.

Terri Vaughan, audit committee member at Verisk Analytics, a data analytics and risk assessment firm based in Jersey City, N.J., says the pressure boards are receiving from investors, customers, employees, and other stakeholders is "off the charts." She adds, "Boards are having to step back, refresh, and ask themselves: What is it that we can do here?" In her view, governance is not complex, but managing all the risks associated with corporate strategies is more than challenging.

Anne Bramman, audit committee member at McCormick & Company, a global flavor company based in Hunt Valley, Md., adds that the required skills of boards are changing. "Companies no longer look for financial expertise only," she explains. "Many focus on deep industry expertise, an information technology background, and financial proficiency. The specific need will depend on the industry."

Cybersecurity, privacy, artificial intelligence (AI), ESG, and diversity, equity, and inclusion (DEI) are common concerns of today's audit committees. Vaughan stresses the need for ESG frameworks and organizations to support their ecosystem, including suppliers, customers, and other stakeholders.

Diane Bridgewater, an audit committee member at Ankeny, Iowa-based convenience store chain Casey's, questions how the use and adoption of AI will change governance. "How are boards making sure they are exploring the use of AI with eyes wide open for deriving its many benefits while managing its risk if guidelines and appropriate use cases are lacking?" she asks.

INTERNAL AUDIT *as a* STRATEGIC PARTNER

As boards struggle to address all these changes and new governance concerns, internal audit can help. The function can start by being a strategic partner to the board.

A flexible audit plan. Annual audit plans are a thing of the past. The contemporary corporate environment, marked by unpredictable changes, demands flexibility and adaptability. Auditors must pivot as situations evolve, aligning strategies with the current landscape.

By continuously benchmarking against developing applicable leading practices, internal audit can recalibrate its audit methodologies to be practical and in sync with modern demands. The area of focus in the Audit Committee Blueprint of "critical alignment" can transpire here.

"Internal audit needs flexibility with its plan and needs to align priorities," Bramman says. "Internal audit can make itself very valuable if it has a holistic approach aligned to strategic objectives."

Going forward it will be more important than ever for internal audit to help audit committees maintain critical alignment throughout the organization in the areas identified in the Blueprint report — culture, purpose, strategy, goals, risks, compliance, controls, incentives, performance metrics, and people.

Auditing with insight and foresight. The evolving role of internal audit can be compared to being on a road trip, with the view out the windshield symbolizing the broad range of possibilities. At the same time, the relatively minor rearview mirror captures the limited scope of hindsight. While the rearview mirror remains essential for analyzing past decisions and actions, the windshield signifies the much more important act of looking ahead to make informed decisions.

Outdated audit functions solely focus on adherence to regulatory norms and processes. The approach of "we can only audit the past, not the future, and we should never be engaged in any project that management is currently working on" has limited merit.

Internal audit must transition from merely assuring compliance to offering strategic guidance to management and the board. The function must be part of the organization's

> ***"Internal audit needs flexibility with its plan and needs to align priorities. [It] can make itself very valuable if it has a holistic approach aligned to strategic objectives."***
>
> **—Anne Bramman**, Audit Committee Member, McCormick & Company

transformation process, and the transformation process must be based on transparency.

Internal auditors should avoid repeating the same messages from management. As a working group member in the Audit Committee Blueprint report noted "make sure the committee is getting information, not just data. ... With real information, the committee will be in a position to discuss and provide insight regarding the critical issues."

The power of the organizational chart. At its core, governance revolves around having the right people in the right positions. In *Good to Great*, Jim Collins defines the triad of effective management: The right people on the bus, the right people in the right seats, and the wrong people off the bus. This philosophy resonates when internal audit considers the organizational chart as more than just a visual representation. Instead, it is a map, pinpointing strengths and weaknesses.

Take for example an observation that materializes during a project review: Some department functions need to align within the hierarchy. The organizational structure can be a contributing factor to inadequate segregation of duties. This is where the organizational chart plays its best card, offering a clear vantage point to divide roles, responsibilities, and chain of command.

A thorough review of an organizational chart should raise leading questions: Is there an appropriate staff allocation? Are the staff's skills commensurate with their functions? Are there discrepancies in the chain of command? Such analysis should not be a one-off review. Instead, to the extent possible, it should be embedded in all audits.

From a board perspective, a main focus here is on talent in the finance department. The Audit Committee Blueprint notes: "...it is critical for the audit committee to stay attuned to the needs of the CFO and the finance organization. Does finance have the necessary leadership, talent, skill sets, and other resources?"

A focus on ESG and DEI. Companies must pay more than lip service to ESG and DEI initiatives. Internal audit must go beyond merely verifying numbers and validating data for these two emerging areas. ESG and DEI should become an inherent part of the audit process. The goal isn't just to validate but to collaborate. The Blueprint report provides a forward-looking consideration to "recognize the increasing stakeholder demand for high-quality ESG disclosures." As one of the working group members observed, "Audit committees today need to focus on the quality of the information that their companies are including in their sustainability reports and elsewhere."

Quality information is possible when auditors partner with the business, offering guidance in devising cost-effective solutions that address long-term ESG challenges.

These solutions may be industry specific. If so, internal audit can benchmark the organization's report against those of its competitors. Benchmarking can help companies discover areas where competitors have reduced waste and increased efficiencies. Organizations engage in these types of initiatives when it makes sense financially, so by looking at the competition, internal

audit can get one step ahead in the decision-making process. Internal auditors can assist management in evaluating profitable and sustainable solutions for their organizations and stakeholders, and as a result improve the value of these disclosures.

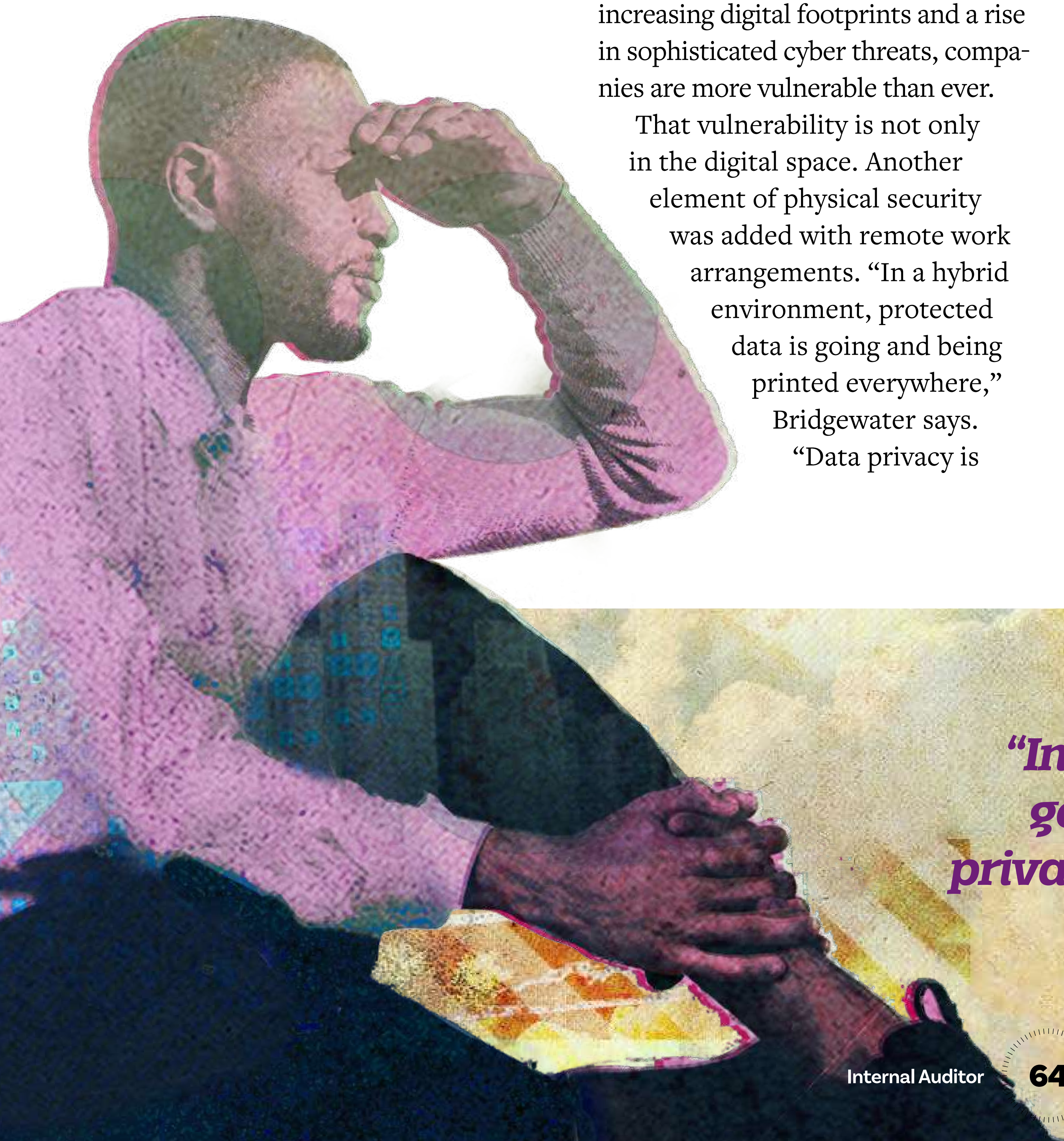
Cyber and privacy risks. Addressing cyber and privacy risks is a must for organizations. It is part of the risk oversight that audit committees need to assess continuously. CAEs who do not include these types of reviews in their audit plan will need to explain why to their boards. With increasing digital footprints and a rise in sophisticated cyber threats, companies are more vulnerable than ever.

That vulnerability is not only in the digital space. Another element of physical security was added with remote work arrangements. "In a hybrid environment, protected data is going and being printed everywhere," Bridgewater says. "Data privacy is much more challenging with a very widely distributed workforce."

Cybersecurity experts agree that user education is the most effective method to prevent cybersecurity and privacy incidents. As a Blueprint report working group member noted, "crisis readiness is critical. Make sure the company is staying on top of its risk assessments."

In addition to tabletop exercises, internal auditors can partner with their IT or learning and development departments to proactively educate users on common attack vectors. A typical cyberattack is business email compromise (BEC). BEC is a cyber scam in which the attacker targets a business, tricking the organization into diverting funds to a fraudster's account. To address this threat, internal auditors can send detailed requests, like a fraudster would, to departments that control disbursements — payroll, accounts payable, and treasury — to raise awareness of these malicious attacks. Why wait for something to happen? Boards want organizations to be crisis ready.

Algorithmic auditing. It is not just a catchy term; algorithmic auditing is a bridge to the future of internal auditing. While some internal audit functions may still not be using technologies such as large language models, machine learning (ML), or other AI, it's undeniable that the use of these technologies is growing. Organizations, and even the vendors partnering with them, increasingly integrate these AI tools into their core processes.



"In a hybrid environment, protected data is going and being printed everywhere. Data privacy is much more challenging with a very widely distributed workforce."

—Diane Bridgewater, Audit Committee Member, Casey's

But with this digital change comes greater responsibility for auditors. Internal audit's value derives from focusing on key, emerging risks. One Blueprint working group member observed, "Internal audit is looking at a broader portfolio of risk today, so they need people with new skill sets. They don't need to be a jack-of-all-trades, but they need to have a deep enough understanding of the issue to assess the risk." This statement could not be more accurate for the internal auditor who is striving to understand AI.

The modern auditor must delve deep into the algorithms, understanding the details of how these models function and, more critically, how they make decisions. The path forward is being able to ask intelligent questions about model transparency, data integrity, decision routes, and potential biases.

If the auditor cannot thoroughly review the ML or AI model in question, an alternative is to test it. For example, if the vendor cannot share its proprietary model, internal audit can use scenario-based testing in which the internal audit team is the customer to validate back-end data. While internal auditors embrace AI's wonders, they must do so with due diligence, responsibility, and a dose of creativity.

FUTURE READY

As digital transformation continues, governance has never been more critical. Boards have gone through significant change over the last three years, and these waves of change will continue. As organizations and boards face new challenges, auditors must have the knowledge and tools to help address them.

Jon Taber, CIA, CPA, CFE, CFF, is an internal audit manager at Casey's in Ankeny, Iowa.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Internal controls that build on the information integrity and security of blockchain systems are necessary to preempt abuse.

Kitty Kay Chan and Tina Kim

When digital assets are recorded with well-designed blockchain technology, they become traceable, stamped with a particular DNA. Organizations are using the technology to prevent fraud and other abuse, facilitate the transfer of funds, and track important records.

Diamond company De Beers uses blockchain technology to track precious stones as they move along the supply chain from mining to sale as polished diamonds. The immutable characteristic of blockchain helps the company ensure that production is not linked to any human rights violations. Likewise, the California Department of Motor Vehicles is adopting blockchain technology to support digitization of its records. Its aim is to prevent car owners and dealers from masking the "faulty car" designations on vehicle titles by transferring ownership back and forth across state lines.

The growing complexity of global business transactions and the potential lack of trust between parties has accelerated the adoption of blockchain technology — but not without challenges. The surge in cryptocurrency-related scams has raised concerns about the use of blockchain as a tool for illegal activities.

The U.S. Federal Trade Commission announced that between January 2021 and March 2022, more than 46,000 people reported losses from crypto scams totaling over $1 billion. Crimes included sales of fake blockchain technology, use of blockchain to create counterfeit financial assets, and hacks into blockchain systems to steal from stakeholders.

When appropriately applied, blockchain technology enables secure, decentralized data storage and data sharing. However, adopting blockchain technology has inherent privacy, confidentiality, regulatory, and cryptographic risks, some of which may not exist in centralized systems. Internal audits play an important role in mitigating those risks; thus, internal auditors reviewing blockchain-based solutions must view them through the lens of potential vulnerabilities.

a compartmentalized approach

At a basic level, blockchain technology is designed to provide a secure digital environment for users to record, store, and share data, in which the information is not controlled by a single party and where any data, once recorded, cannot be altered. Hence, internal controls must ensure that the foundational elements of the blockchain system, such as its nodes, consensus mechanism, cryptographic algorithms, and off-chain transactions, work together

De Beers uses blockchain technology to track precious stones as they move along the supply chain from mining to sale as polished diamonds.

to maintain only correct information, preempt unauthorized access to the system, and protect the privacy of participants (see “Blockchain Terminology” on this page).

A comprehensive blockchain audit that involves technical analysis of the hardware and software as well as governance, risk management, and compliance review is crucial, but the time-consuming nature of such audits hinders their ability to provide timely information to fight the quickly evolving risks of blockchain-related activities. To address this challenge, auditors can adopt a more targeted approach that considers the specific method of deployment, the associated risks, and the relevant controls. This more focused strategy allows auditors to concentrate their efforts where they are needed and provide more timely insights.

how does the system stack up?

Internal controls serve as the frontline of defense. Strong internal controls focused on safeguarding information integrity and security can prevent or identify vulnerabilities that can be exploited by others. While orgnizations may need to engage external technical partners

blockchain terminology

A blockchain is an encoded, decentralized, append-only digital ledger that is maintained across a network of independent devices. Each blockchain is unique, but there are several foundational elements that make up every blockchain system.

blocks

Individual data storage units in a blockchain. Once a new block is added to the chain, it is immutable, creating an append-only ledger where new information can be added, but recorded information cannot be modified.

nodes

Any computing device connected to the blockchain system, together creating a blockchain network.

cryptographic algorithm

Helps safeguard the security of information in the blockchain system. Cryptography is used to render information immutable and create digital signatures that enable information sharing among designated parties only. Blockchain typically uses both hashing and asymmetrical algorithms for information security.

consensus mechanism

A set of protocols laying out how information, such as a financial transaction, health record, or status of a shipment, is verified and added to the system once a user initiates a transaction. The consensus mechanism provides the conditions under which the transaction can be verified, added to the block, and chained to the existing blocks.

to examine certain components of the blockchain system, auditors who understand the relevant internal controls can be routinely and actively involved. Internal auditors new to blockchain auditing can start with a checklist of the internal controls needed to safeguard each of the foundational elements of the blockchain system.

Review nodes to ensure information comes from reliable sources. Depending on their functionality, nodes can broadly be classified as full or light nodes. Full nodes, potentially a personal computer, can verify the system rules and maintain a full copy of the digital ledger. Light nodes, such as a digital wallet, maintain only a partial copy of the digital ledger and are not capable of verifying the system rules.

To ensure that information coming into the system is from a reliable source, auditors should examine whether policies and controls are in place to verify that the nodes are genuine. Internal audit should review the nodes' software version, IP address, transaction history, reputation, and uptime to search for anomalies.

The genuine nodes of a specific blockchain use the official software associated with the blockchain system and should each have a unique IP address that is registered with the system. For a private blockchain system, genuine nodes should have received system access permission. Nodes with no activity for an extended period should raise red flags, as this could indicate a node that was created solely for the purpose of carrying out a fraud.

A node from a legitimate participant could still become an unreliable source if vulnerabilities in its software allow unauthorized actors to tamper with information. Thus, it is important to check that the software is the latest version and that all security patches are installed.

Check that recorded information is accurate and validated according to the consensus mechanism. In a blockchain system, information is recorded across the ledgers of all the nodes when it passes the consensus mechanism specific to the system. There are many types of consensus mechanisms.

To protect against Sybil attacks, in which scammers operate many fake nodes to create fake consensus, it is possible to incorporate a proof of work (PoW) or proof of stake (PoS) process as a part of the consensus mechanism. This is commonly used to deter the creation of fake nodes by making it costly to do so. For example, under PoW, nodes compete to solve mathematical puzzles to gain the right to validate a transaction and earn a fee for doing so. These calculations require substantial computing power, making it more expensive to create fake nodes.

To check for appropriate validation, auditors should confirm whether policies and controls ensure the blockchain system is operating in a way consistent with its consensus mechanism. For example, do the controls include PoS verification? Under PoS, only nodes that stake a certain amount of assets as collateral can enter a random draw to win the right and fee to validate a transaction.

The consensus mechanism will validate the

Off-chain transactions increase the system's exposure to scams and illegal activities.

transactions but does not check the correctness of the information submitted by the parties. Thus, it is crucial for auditors to examine the accuracy of the information through substantive testing, using supporting documents such as invoices and receipts.

Examine if controls are in place over the use of the cryptography. A hashing algorithm is the powerhouse behind blockchain that makes information immutable. In general, the hash algorithm transforms original information on a block into a hash value, which is a unique, incomprehensible, and highly irreversible text string. Each block on the same blockchain contains the hash value of the processor block. Any attempt to modify information on a block will create inconsistency among the hash values and break the chain.

Asymmetrical algorithms securely share information, using keys, among two parties. Each party holds a set of keys comprising a public key and a private key. Private keys should be kept confidential while public keys are sharable.

To send a monetary payment, a sender uses the recipient's public key to encrypt the message. The sender can use his or her own private key to generate a digital signature. The recipient then uses a private key to decrypt the message and receive the payment. The recipient or anyone with the sender's public key can view any digital signature and be assured the message is from the signee. Other common applications of asymmetrical algorithms include creating emails and virtual private network connections for secure communications.

Procedures should indicate how the use and management of the cryptography-related components will be reviewed and who will do so. Only authorized persons should review, test, and make changes to the cryptographic approach.

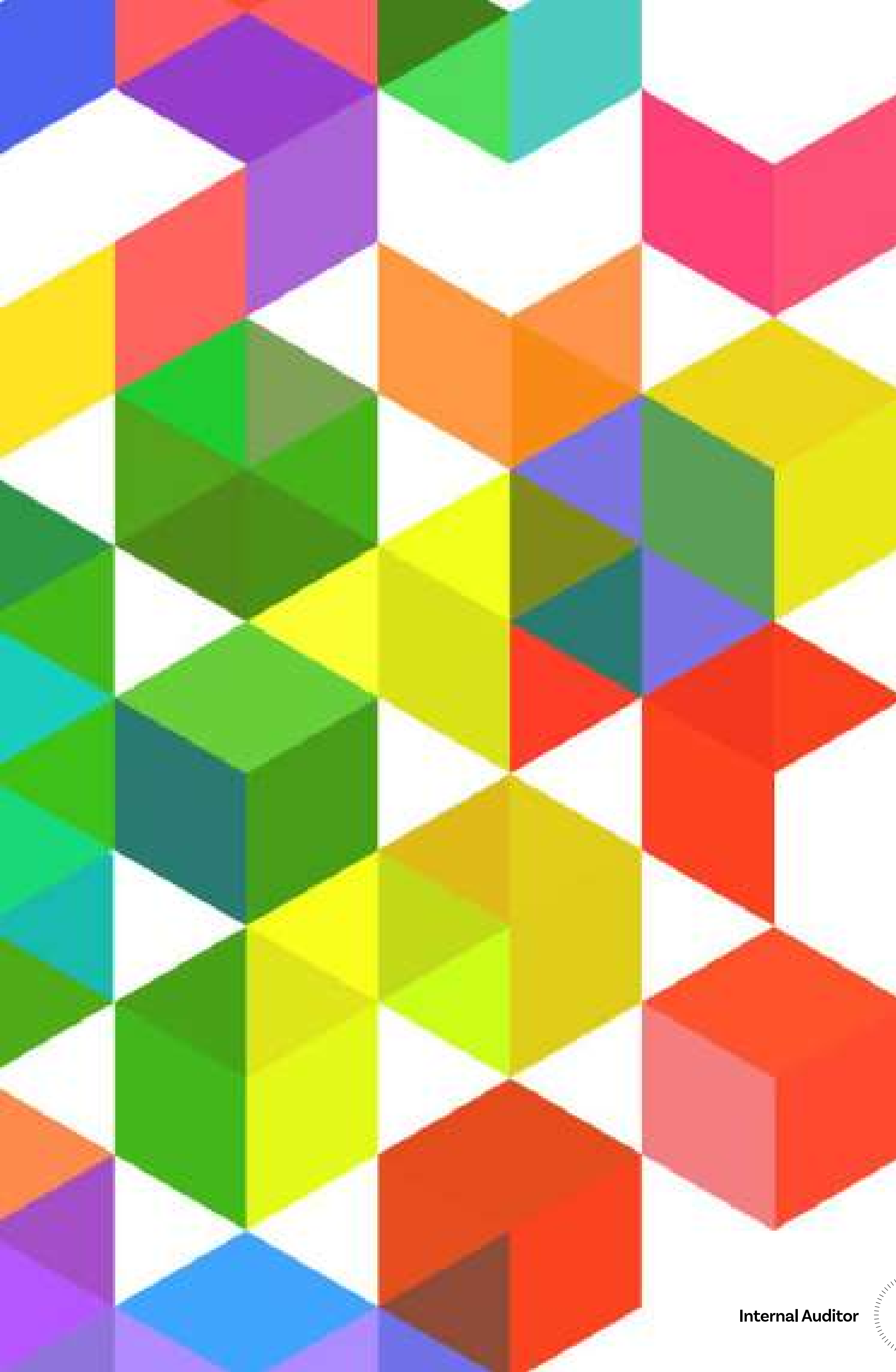
Reviewers should check that the hash and asymmetrical algorithms applied to the system are widely accepted and verify that the cryptographic approach adopted by the system is working as intended. A review of the keys can determine if they meet the expected properties of the cryptographic system, such as the right composition and length, and whether additional security measures like two-factor authentication have been incorporated into the cryptographic approach.

Key management is crucial for maintaining the system's security and preserving information integrity. Processes should be in place to protect keys throughout their life cycle, including generation, registration, storage, distribution, installation, recovery, and disposal. The identity of key holders should be verified, and procedures for storing keys and generating lost keys should be clearly laid out.

Assess off-chain transactions to assure information is complete and reliable. As the name suggests, off-chain transactions are conducted outside the blockchain system. An example could be when one party sells its private key to another party outside of the blockchain system.

Unlike on-chain transactions, off-chain transactions are not validated through the consensus mechanism, but rather rely on third-party guarantors for verification. They may or may not be recorded in the system after they are completed. Off-chain transactions thus increase the system's exposure to scams and illegal activities.

Internal auditors should check whether there are any off-chain transactions linked to the assets in the blockchain system being reviewed and determine the business justification for moving these parts of the transactions off-chain. To ensure the information recorded in the



blockchain is complete and reliable, auditors should verify that appropriate policies and controls are in place to track off-chain transactions.

Internal auditors should be able to verify the parties involved, as well as the time and the amount of these off-chain transactions. Similar to working with on-chain transactions, auditors should verify the accuracy of the off-chain transactions by cross-checking with supporting documents such as invoices, receipts, and average industry prices of any products linked to the transaction.

getting all areas aligned

There are many other controls and scenarios that auditors can investigate to help safeguard information integrity and security. For example, they can examine:

- Whether governance is established to guarantee that the integration of blockchain technology into the existing operating system is working as intended.
- Whether business continuity and disaster recovery plans and processes have been updated to account for potential changes resulting from the adoption of the blockchain system.
- If the system meets relevant industry standards and legal requirements, depending on the application that a blockchain system is built for. In the U.S., blockchain-based cryptocurrency exchanges must comply with regulations, such as the Bank Secrecy Act, and must register with the Financial Crimes Enforcement Network of the U.S. Department of the Treasury.

the leading edge of blockchain security

Blockchain-related products are new to many organizations but have been evolving at a fast pace. Internal controls with a focus on safeguarding information integrity and security make it possible to fight against blockchain crimes timely. Strong internal controls are thus a critical first line of defense — along with comprehensive audits conducted in partnership with external blockchain audit professionals.

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IIA Chicago

CONGRATULATIONS

to the **2023 Annual Award Recipients** of The Chicago Chapter of the IIA!

William C. Anderson Member of the Year

NATALIE COVELLO, CIA, CRMA, CFE

Manager | Enterprise Risk Management at DePaul University

Chapter Roles: *Treasurer of IIA Chicago Chapter*

Who is William C. Anderson?

William was a member of the Chicago Chapter Board for 35 years and a former chapter President. He also served on the IIA's International Committee for 20 years, was a founding member of the Research Foundation, raised more money for the Foundation than any single individual, and was co-Chairman of the 1993 International Conference in Chicago.

Dr. Sandra Shelton Educator of the Year

KELLY RICHMOND POPE, CPA

Professor at DePaul University

Who is Dr. Sandra Shelton?

Dr. Shelton was a longtime DePaul University professor who played an integral role in establishing DePaul's Internal Audit Education Partnership program (IAEP) with the Institute of Internal Auditors (IIA). The IAEP is the IIA's flagship partnership program with universities and colleges. Dr. Shelton is one of the few black women to become a full professor with an endowed chair.

Auditor of the Year

DAVE MALCOM

Senior Vice President | Audit Services Managing Director, Data and Digital at Northern Trust Corporation

Innovator of the Year

JOSEPH GONSKI

Senior Vice President | Data Analytics Program Lead, Audit Service at Northern Trust Corporation

Committee Chairperson of the Year

ALLISON CANCIO, CIA, CRMA

Global Director | Performance and Risk at JLL

Chapter Roles: *Board Member, Membership Chair*

Special Recognition

PUJA SHAH

Executive Director at UBS

Chapter Roles: *Chapter President*

Special Recognition

KRISTINA BUDAJEVA

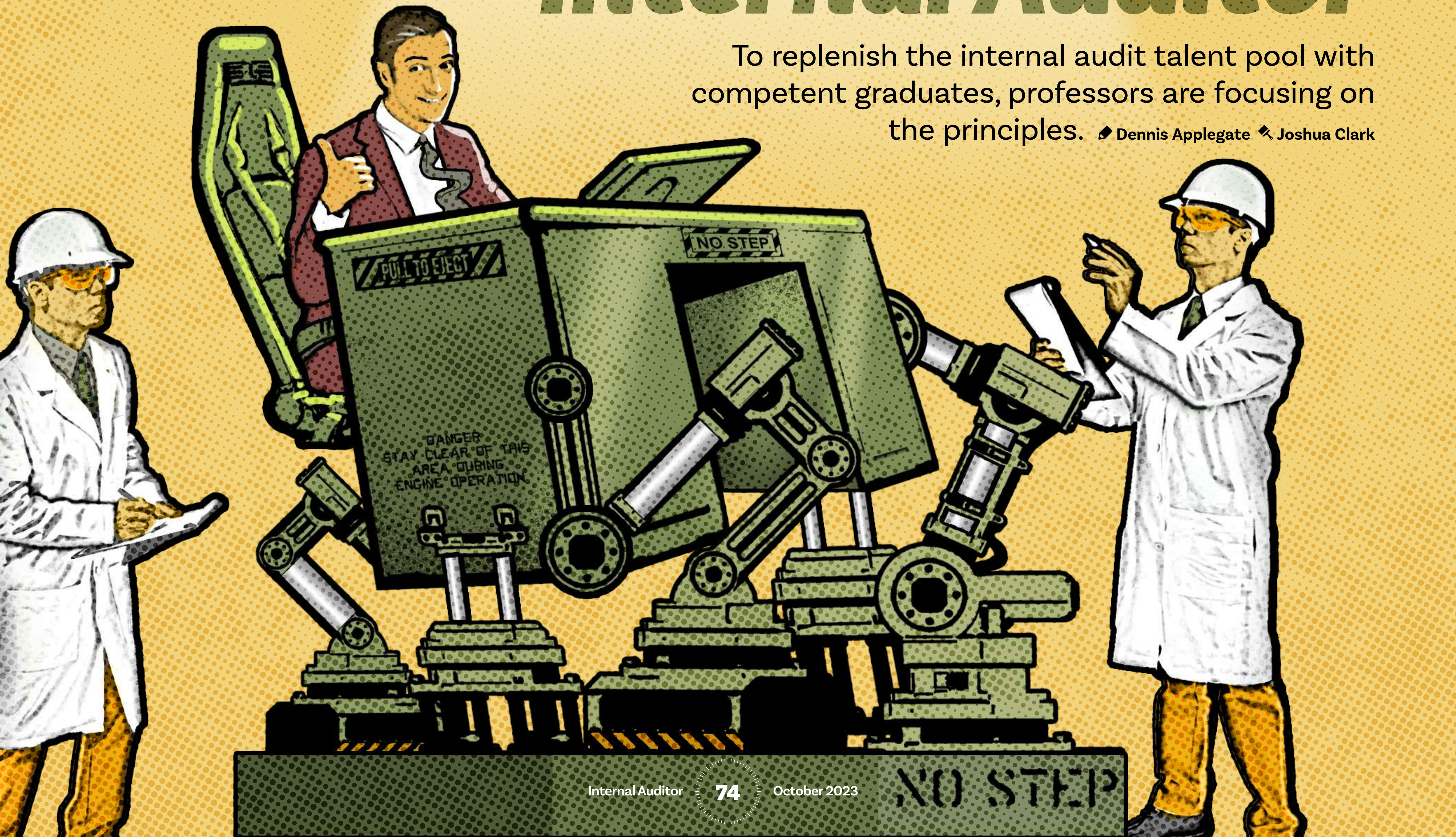
Associate Director at UBS

To learn more about the IIA Chicago Chapter and our events, please visit our website:
www.theiia.org/en/chapters/united-states/illinois/chicago/

Training Tomorrow's Internal Auditor

To replenish the internal audit talent pool with competent graduates, professors are focusing on the principles.

Dennis Applegate · Joshua Clark

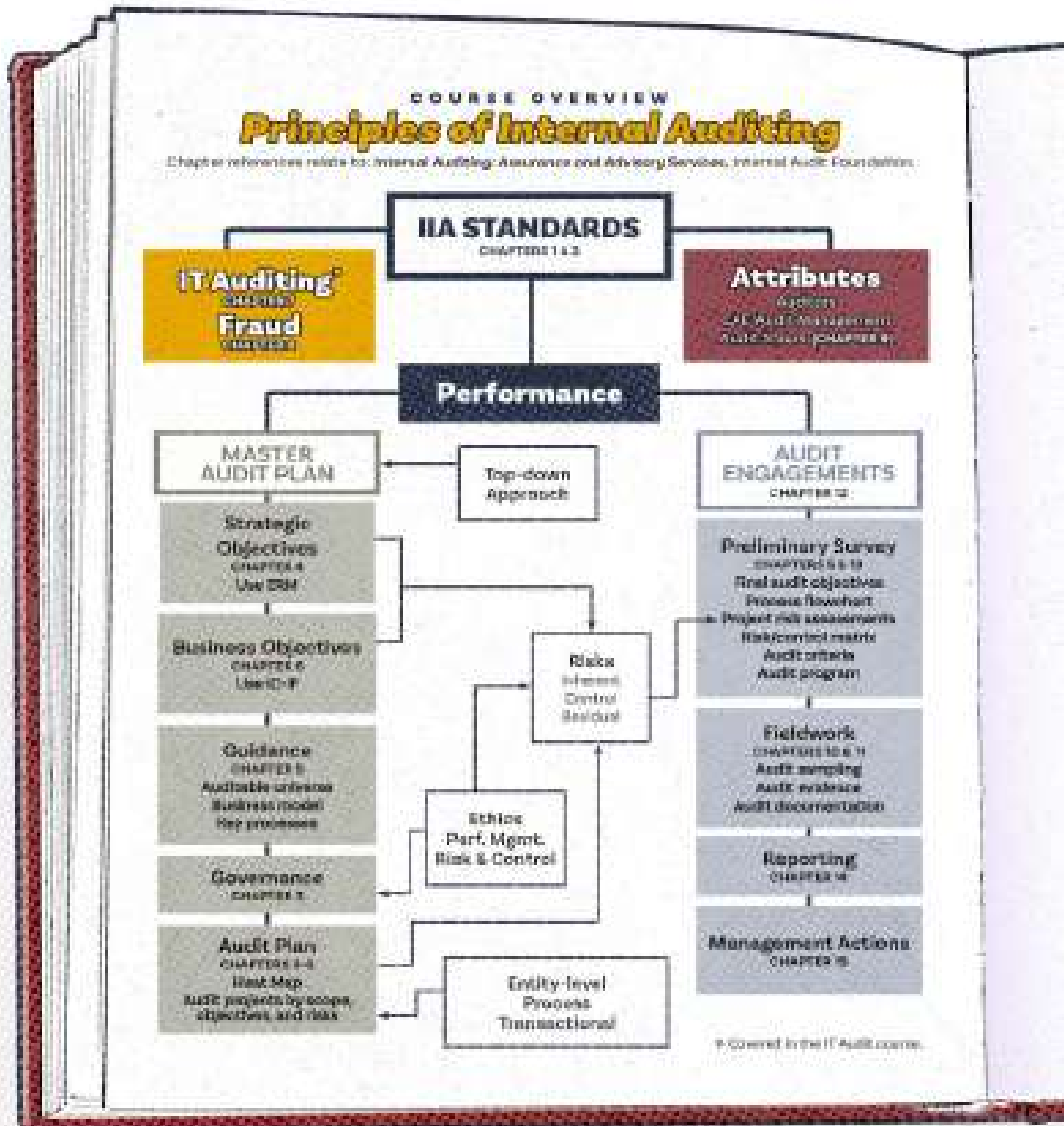


Finding the next generation of internal auditors is a growing concern to industry and the profession. Statistics presented in the 2022 Internal Audit Foundation report, Internal Audit: A Global View, show the number of early career internal audit practitioners shrinking while practitioners age 50 and above represent an increasingly larger proportion of the internal audit workforce. As these older practitioners retire, many colleges and universities are helping replenish the internal audit talent pool by exposing students to the career-enhancing potential of the profession.

For guidance on course coverage, universities often look to The IIA's Global Model Internal Audit Curriculum. The curriculum contains sample learning objectives and content recommendations for six core courses and six supplemental courses covering a wide range of internal audit knowledge and skills — from business communications to fraud and forensics.

The IIA formally recognizes and endorses universities that teach internal audit curriculum through the Internal Auditing Education Partnership Program (IAEP) and Internal Audit Awareness Program (IAAP). The amount of internal audit curriculum an IAEP school offers determines its classification as an Internal Auditing Foundation, Comprehensive Internal Auditing, or Center for Internal Auditing Excellence school.

Principles of Internal Auditing, the only core course that cuts across all three IAEP programs, helps prepare students for success on the first two parts of the three-part Certified Internal Auditor exam. The "Course Overview: Principles of Internal Auditing" flowchart on this page provides an overview of how such a course might be structured, reflecting two key audit process streams: audit engagements and annual audit planning.



The case provides a real-world example of how internal auditors can show their proficiency not just as auditors, but also as consultants, even during an assurance engagement.

Although the course should address all content recommendations, instructors often emphasize select topics of key importance to prospective internal auditors. In the course I teach at Seattle University, the topics emphasized are the internal audit value proposition, the three pillars of internal audit services, risk and materiality, auditor bias, annual audit risk assessments, and audits of ethics and values within the organization.

The Pillars of Effective Internal Auditing

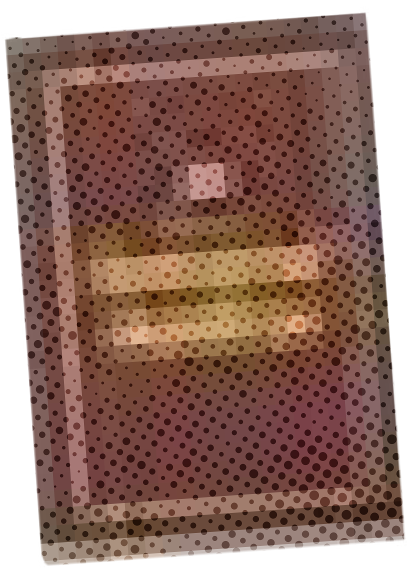
Principles of Internal Auditing addresses The IIA's *International Standards for the Professional Practice of Internal Auditing* in detail, relying heavily on Implementation and Supplementary guidance such as Practice Guides to explain and bolster requirements. Special attention is paid to Standard 1100: Independence and Objectivity, and Standard 1200: Proficiency and Due Professional Care, the pillars of effective internal audit services.

In class, students are given practical examples of each pillar to drive home its criticality. For instance, with Proficiency, the class is shown how simple economics supply and demand curves can be used to respond to a client question about the effect that a decline in market prices may have on executive bonuses if the price decline falls below the price of a current purchase commitment. The case provides a real-world example of how internal auditors can show their proficiency not just as auditors, but also as consultants, even during an assurance engagement.

At this juncture, it is important for students to understand that internal auditors are "consulting" any time they are helping to improve the conditions or circumstances of a client, though they must avoid controlling the outcome, an action that falls outside the purview of internal auditors. Control would indicate that they are managing — not permissible under IIA *Standards* — rather than consulting, a key point of emphasis for instructors.

It also is important to teach students that whenever

Students are taught it is their job to explain the value of internal auditing at the audit entrance conference and throughout the audit, especially when access to records is an issue.



internal auditors are asking or telling their clients about problems, they should be pivoting to problem solutions, advising but not directing. My in-class discussion of the pillars provides an opportunity for the instructor to drive home these key points about the consultative nature of the internal audit profession.

Similarly, when the course covers Standard 1000: Purpose, Authority, and Responsibility, the components of an internal audit charter, the instructor should address head-on what is common knowledge in the audit industry: Most people do not like to be audited. Why? Because, often, people fail to understand the internal audit value proposition. For this reason, students are taught it is their job to explain the value of internal auditing at the audit entrance conference and throughout the audit, especially when access to records is at issue. Hiding behind the internal audit charter usually is not the best way to engender employee cooperation.

A Deep Dive Into COSO

Another course emphasis area, risk and materiality, is crucial to a student's understanding of the internal audit process. Key takeaways include risk assessment (What could go wrong?) and risk management (What's the response?), both of which are reviewed in depth based on the COSO *Enterprise Risk Management (ERM)–Integrating With Strategy and Performance* framework.

Although COSO ERM describes at least four management responses to risk (i.e., accept, avoid, share, and reduce), corporate strategies that reduce risk through internal controls often receive heavy emphasis given the tendency of corporate boards to align their strategy with risk appetite and tolerance.

Thus, a deep dive into the COSO *Internal Control–Integrated Framework* is needed to tie assessed risk of a material nature to the controls designed to mitigate it. Here, a sharp distinction is drawn between documented control components and actual control execution in that research has shown the preponderance of control failures relate more to employee behavior than to control design.

Evidence gathering is crucial to a successful audit engagement, but interjecting any form of auditor bias into the work can jeopardize the quality of the audit result. Students are introduced to three types of common auditor bias:

Availability bias: focusing the audit on information either readily accessible or that immediately comes to mind, rather than on information with the most probative value.

Anchoring bias: using prior audits as a starting point for a current audit regardless of changed circumstances, or relying on the first audit evidence spotted regardless of its accuracy or relevancy.

Confirmation bias: pursuing audit data that supports a pre-existing view about an audit matter while ignoring or rejecting contrary evidence out-of-hand.

When in-class examples accompany each bias, a lively discussion typically follows.

A Group Project

IIA Standard 2010: Planning guides the annual risk assessment for the audit plan and schedule. My group project, Annual Audit Risk Assessment and Master Audit Plan/Schedule, enables students to apply what they have learned in Chapters 3 through 6 of the textbook to the risk profile of a publicly held firm, researching over the internet and elsewhere events that may affect that profile. The objective of the project is to provide hands-on training to prospective internal auditors in annual

The New Global Internal Audit Standards

All course criteria will be updated upon release of the new Global Internal Audit Standards™ expected to take effect in late 2024.

risk assessment practices and audit plan development.

Students benefit when they must present and defend their annual risk assessment and master audit plan to a group of internal audit professionals serving as a hypothetical "audit committee." I have relied on senior audit managers from firms such as Boeing, Deloitte, Microsoft, and Protiviti for this purpose.

The committee evaluates each presentation based, in part, on the thoroughness of the risk assessment, including its underlying rationale and the facts and data that support it. It also evaluates the logic of the relationship between the key risks affecting achievement of the firm's business objectives and the projects proposed in the audit plan.

For their presentations, students are encouraged to inform and persuade the audit committee as to the validity of their proposed audit plan and schedule in light of assessed risk. They should allow plenty of time for Q&A to convince the committee that the plan is adequate. The logical flow from strategy to risk assessment and from risk assessment to audit plan drives the audit committee's evaluation of these projects.

To date, the companies risk-assessed include Alaska Airlines, Costco, Expedia, Nordstrom, Paccar, Starbucks, and T-Mobile. The content of the assignment provides the course instructor with a teaching opportunity on a subject not familiar to most students, and the application of the project requirements provides students with training in a real-world aspect of the internal audit profession.

An Ethics Case Study

Because of the corporate scandals that continue to trouble the business world, we also spend substantial class time on Standard 2110: Governance. According to this standard, "the internal audit activity must assess and make recommendations to improve the organization's governance processes including ethics and values within the organization." Therefore, students must not only be cognizant of the elements of a well-designed ethics program, but also understand how to audit the program.

To jump-start discussion, the class reviews a few of the recent ethical failures impacting corporate governance, including Wells Fargo Bank's fraudulent marketing practices, Airbus's foreign bribery case, Kraft-Heinz's inflated cost-savings from its merger, and EY and KPMG's ethics exams scandals. Reviewing these ethical breakdowns typically promotes a robust interchange

8 Elements OF A WELL-DEFINED ETHICS PROGRAM

1. **A written code of conduct**
2. **Tone at the top** (also in the "middle" and at the "bottom")
3. **Employee certifications** documenting that they have read, understand, and will comply with the code of conduct
4. **Recurring employee ethics training**
5. **An ethics hotline** for reporting violations that includes protections for whistleblowers
6. **Investigations of ethics violations**
7. **Disciplinary procedures** to ensure violations are addressed
8. **Periodic internal audits** assessing the adequacy and effectiveness of the program

of the ways internal audit can help improve corporate governance. The discussion sets the stage for an IIA ethics case study assignment, Auditing the Compliance and Ethics Program, an instructor resource that accompanies the course textbook.

The case study introduces ethics and business conduct as a governance process and causes students to think through in practical terms internal audit's role in the corporate ethics program. To prepare for the case study, the class reviews commonly understood, standard elements of an ethics program. (See "8 Elements of a Well-defined Ethics Program" on page 78.)

To show the connections between program elements, students learn that elements 1 and 2 relate to corporate intentions, and 3 and 4 relate to corporate integrity. The question here is do actions match intentions? Elements 4 through 7 relate to compliance or whether corporate actions are appropriate considering intentions, and 8 relates to whether there is accountability when violations occur.

Student study teams apply the standard elements to the factors and circumstances of the assigned case, brainstorm risks and expected process controls, and prepare an audit report on findings and recommendations. All of this mirrors the audit engagement process outlined in the "Principles of Internal Auditing Flowchart" and covered in chapters 12 through 15 of the textbook.

Replenishing the Talent Pool

The path to a well-taught Principles of Internal Auditing course is not easily navigated in a rapidly changing audit environment where even The IIA's *Standards* are evolving. Colleges and universities willing to make the journey are encouraged to maintain close connections with The IIA and senior internal audit leaders in their region to ensure that class time is focused on key topics of primary concern to the profession.

Credentialed readers of *Internal Auditor*, in conjunction with their local IIA chapter, should consider partnering with the business schools of colleges and universities in their locale to develop and teach internal auditing curricula compatible with The IIA's *Standards* and internal audit procedures and professional practices. The institutions, if successful, will gain a reputation for educating students who are knowledgeable of business risk and control, and the internal audit profession will benefit from competent graduates ready to replenish the internal audit talent pool.

Dennis Applegate, CIA, CPA, CMA, CFE, is an assistant clinical professor of accounting in the Albers School of Business and Economics, Internal Audit Center of Excellence, at Seattle University.

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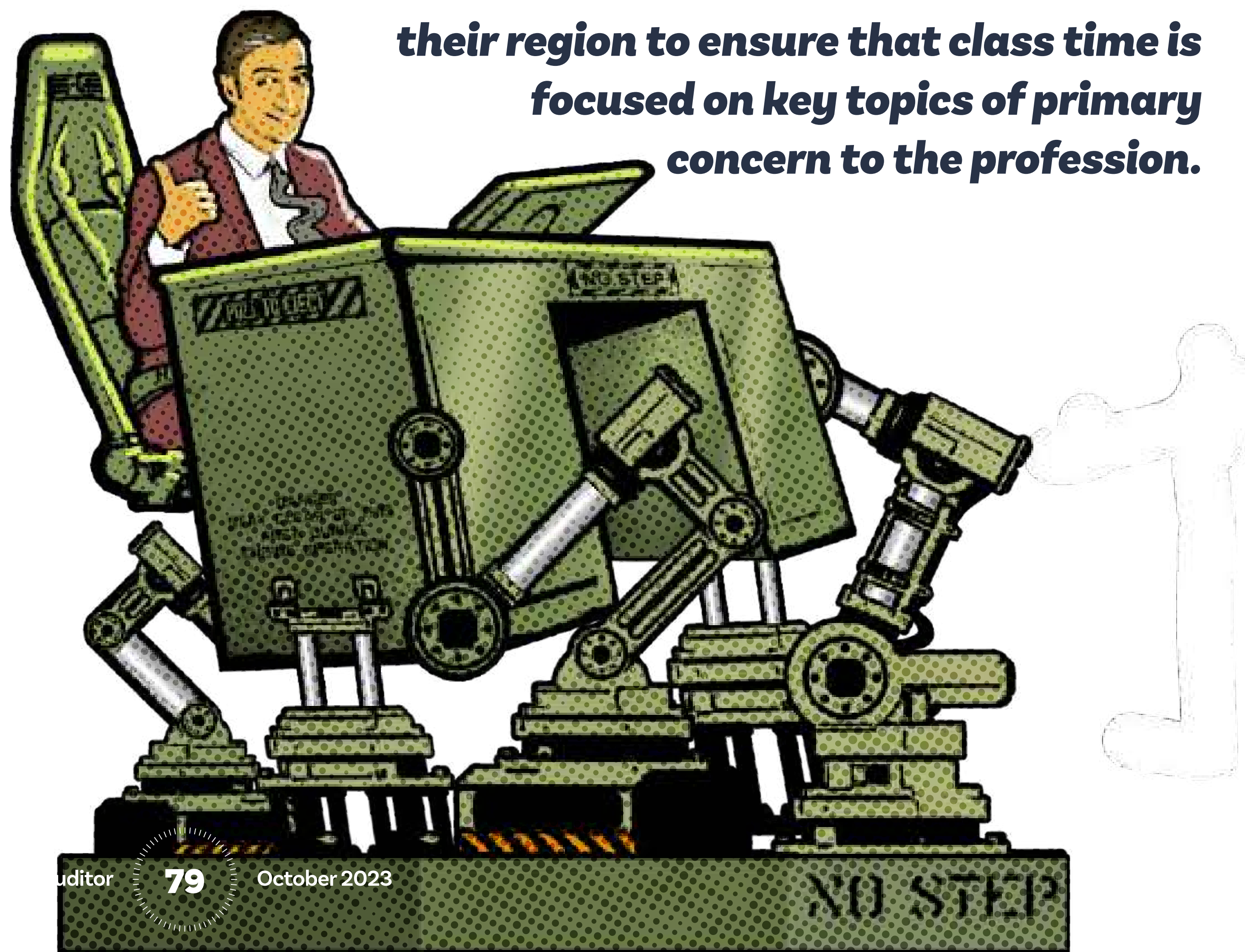


The Standards Board

has reviewed more than 18,900 comments submitted in more than 1,600 surveys from respondents in 135 countries and territories. The results show strong overall support and provide constructive suggestions that the Standards Board is currently considering.

Stay tuned at
theiia.org/IPPFEvolution
for more information.

The Institute of
Internal Auditors

boardroom

An Aggressive Action

The PCAOB's NOCLAR proposal raises questions about the external auditor's role in investor protection.

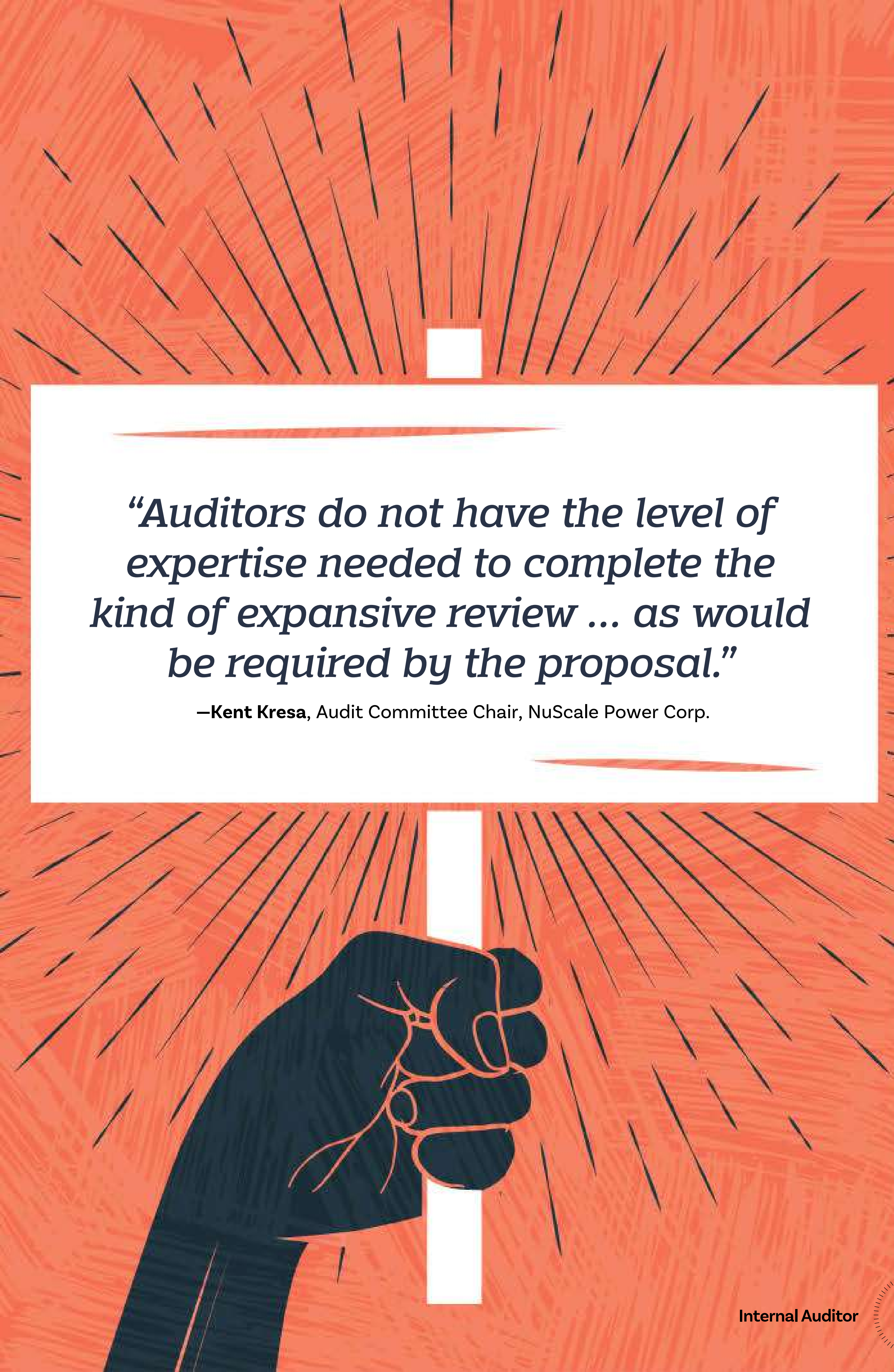
Matt Kelly

Fall may be here in the U.S. but rest assured — a proposal floated by the Public Company Accounting Oversight Board (PCAOB) this summer is likely to keep the audit and corporate governance communities sweating for quite some time.

The Non-compliance With Laws and Regulations (NOCLAR) proposal would require external audit firms to look more aggressively for compliance and legal violations at their client companies. When the audit firm does find potential violations, it would then need to report them to the board and management team more quickly, too.

Sounds reasonable and noble enough, right? If the audit firm brings compliance violations to the company's attention, management would then need to address those concerns more quickly, and that benefits investors. What's not to like about that idea?

A lot, according to feedback the PCAOB received throughout the summer. Scores of comment letters arrived from audit committees, audit firms, compliance officers, governance activists, and many more corners of the corporate governance world. Divisions over the NOCLAR proposal run deep, touching on profound questions about the role of auditors in investor protection.



One representative comment came from the Audit Committee Council, an association of corporate board directors that acts under the auspices of the Center for Audit Quality, a lobbying group for the audit industry. "We are concerned that the proposed amendments in the NOCLAR proposal are significantly broad in scope," the council's letter said. NOCLAR "tasks the auditor with responsibilities for which they do not have the expertise and will come at a significant cost without a commensurate benefit for what it seems the PCAOB is aiming to accomplish."

That's quite the denunciation for something that sounds, at the abstract level, like a good governance idea. So, what's really at stake here for auditors and audit committees that it's provoking such fierce controversy?

'Auditors Are Not Lawyers'

The audit firms' chief complaint is that the NOCLAR proposal would force them to act as lawyers, a task audit firms are not well-suited to do. Specifically, the proposal would require them to identify laws and regulations applicable to the company "and where non-compliance could have a material effect on the financial statements."

Consider what that means. For auditors to identify the laws and regulations that might have a material effect on the company's financial statements, they would first need to identify all the laws and regulations that apply to the company so they could pare down that list to whichever ones could have a material effect on the financials.

That is a potentially enormous expansion of the auditor's risk assessment, and many audit firms would likely need to consult with outside experts. Hence one common refrain among the NOCLAR critics: "Auditors are not lawyers."

"Auditors do not have the level of expertise needed to complete the kind of expansive review ... as would be required by the proposal," wrote Kent Kresa, audit committee chair at NuScale Power Corp. "Auditors are not lawyers ... additional costs will be imposed upon us by the proposed approach because public audit firms will seek to hire qualified audit, legal, and other specialized staff from the same sources as we do."

The NOCLAR proposal also raises slippery questions about how external auditors would interact with internal auditors and corporate compliance teams. For example,

NOCLAR would drive external auditors to make independent assessments of the company's compliance posture, something far outside the comfort zone of most boards and management teams.

the proposed standard would have external auditors ask the internal audit team whether it is aware of any potential compliance violations.

That's a perilous question for internal audit. If the internal auditor doesn't know of any violations, and the external auditor subsequently does find one and reports that to the audit committee, the internal auditor will look bad. Or if the internal auditor does know about a compliance or legal violation, is he or she just supposed to admit that to the external auditor? Because such a disclosure would most likely leave the general counsel or compliance officer incandescent with rage.

That brings us to two other lines of complaint about NOCLAR. First, corporate lawyers worry that the proposal could undermine attorney-client privilege. Corporate compliance officers, meanwhile, want the proposal amended so that external auditors would need to ask them about possible compliance risks, and have the auditor consult with the board's committee that oversees the ethics and compliance program.

One such comment came from Douglas Currault, general counsel of mining giant Freeport-McMoRan. He worried that auditors might demand to see documents typically protected by attorney-client privilege — a privilege that vanishes when said information is disclosed to a third party.

More broadly, oversight of a company's compliance program is the purview of the board, the management team, and the general counsel, Currault wrote. The NOCLAR proposal would "require the auditor to independently determine noncompliance with laws and regulations … this could result in situations where the view of the auditor's legal specialist conflicts with the company's legal opinion."

His comment reaches the crux of the issue: NOCLAR would drive external auditors to make independent assessments of the company's compliance posture, something far outside the comfort zone of most boards and management teams.

Is that appropriate? Does it leave audit committees stuck between management teams and auditors pitted against each other? How do internal audit and compliance teams fit into that more adversarial picture?

The Argument in Favor of NOCLAR

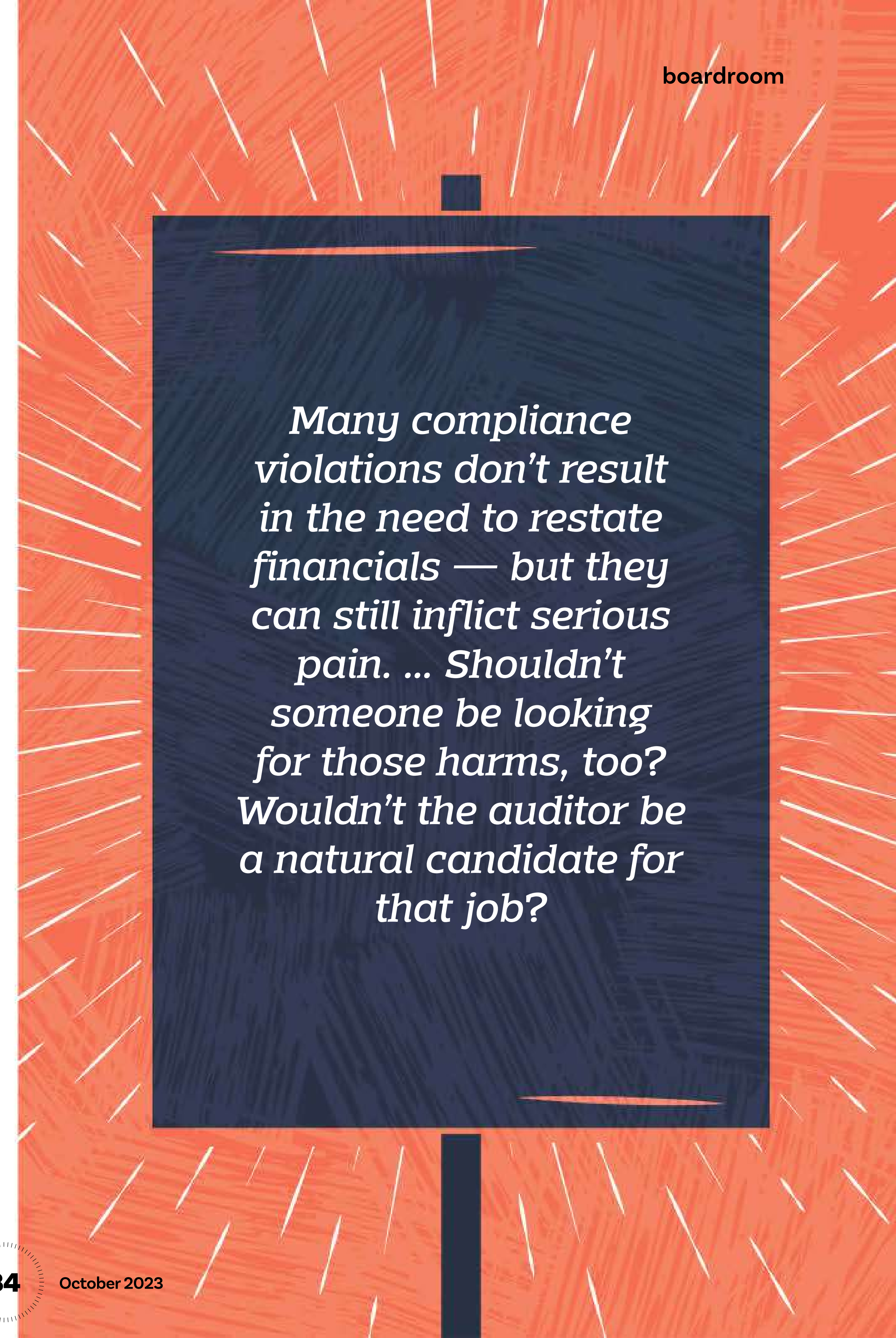
The voices in favor of the NOCLAR proposal point out that existing standards for auditors and clients' legal violations hail from the 1980s and need a makeover for modern times. Plus, federal securities law does require that when auditors come across evidence of an illegal act, they are first supposed to report that discovery to the audit committee, and ultimately to regulators if the board takes no action. So supporters say the NOCLAR proposal only clarifies and strengthens what auditors should already be doing anyway.

Jon Lukomnik, a long-time good-governance activist who served on the creditor committees after the WorldCom and Adelphia Communications scandals in the early 2000s, wrote to the PCAOB: "Those instances of noncompliance and the auditors' failures to detect them earlier were direct motivations for the passage of the Sarbanes-Oxley law. ... Clearly noncompliance was, and should still be, at the heart of investors' and policymakers' concerns around audit quality."

Lukomnik gets to another central issue here: the range of corporate fraud that auditors should be looking for. Should auditors stick with their primary duty to find risk of material misstatement in the financial statements? Many compliance violations don't result in the need to restate financials — but they can still inflict serious pain to investors in the form of depressed share price, regulatory settlements, higher costs, and management turnover. Shouldn't someone be looking for those harms, too? Wouldn't the auditor be a natural candidate for that job?

Those are the battle lines drawn by the PCAOB's NOCLAR proposal. We don't know when the PCAOB might issue a final standard (if at all) or how that final version might differ from the original proposal. But the debate to come is likely to be prolonged, profound, and contentious; the entire corporate governance community should pay attention.

Matt Kelly is editor and CEO of RadicalCompliance.com, an independent blog about audit, compliance, and risk management.

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the big idea David Salierno

Proximity could power a business boon in innovative urban communities.

Is a city where residents can get anywhere they need to go in 15 minutes really possible? A new generation of urban planners thinks so.

For city commuters whose lives move to the rhythm of rush hour, the prospect of leaving daily gridlock behind may sound too good to be true — but it's not at all far-fetched.

Cities offer a host of advantages to residents: economic opportunity, entertainment, education, and access to advanced healthcare, to name just a few. And for businesses, the concentration of consumers and potential talent can be critical. But time spent sitting in traffic is often significant: more than 150 hours a year in Chicago, 122 hours in Bogota, Colombia, and 156 hours in London, according to transportation analytics company INRIX's Global Traffic Scorecard. That can discourage potential residents and present a barrier for businesses. And with the United Nations projecting that more than two-thirds of the world's population will live in cities by 2050 — up from just over half currently — the situation is likely to get worse.

That's in part why there is growing interest in the development of 15-minute cities. "These neighborhoods, where you don't need a car and can easily access almost anything you might need on foot or bicycle, are very much in demand," says Francisco Alaniz Uribe, associate professor, School of Architecture, Planning, and Landscape, and co-director of the Urban Lab, at the University of Calgary in Canada. In fact, around the world in places such as Zurich, Vienna, Paris,

"These neighborhoods, where you don't need a car and can easily access almost anything you might need on foot or bicycle, are very much in demand."

—**Francisco Alaniz Uribe**, Associate Professor, School of Architecture, Planning, and Landscape; Co-director, Urban Lab, University of Calgary and Portland, Ore., they're already becoming a reality (see "The Foot-friendly Metropolis" on this page).

More widespread adoption of the 15-minute city concept could offer numerous benefits across stakeholders, including better quality of life for residents, business opportunities for organizations, and increased revenue for municipalities. But there is a lot to consider — and ground to cover — before those benefits can be fully realized.

Reinventing the Neighborhood

The advantages of 15-minute cities to residents go far beyond spending less time in traffic, saving money on fuel, and reducing one's carbon footprint. "In walkable places, where we live closer together, there are more of us paying for infrastructure. That means we can have a better transit system, better roads, better sidewalks, better parks, and more public places," Alaniz says.

These quality-of-life improvements also can benefit businesses, as promoting their location near cities with such desirable features could help with recruiting and retention. Alaniz points to the desire among many younger workers to live in a walkable neighborhood, noting that

The Foot-friendly Metropolis

The 15-minute city is becoming a reality in cities around the globe.

Paris

Mayor Anne Hidalgo campaigned on turning Paris into a 15-minute city. The plan calls for a bike lane on every street by 2024 and removes 60,000 on-street parking spots, replacing them with green spaces. The city has banned cars one Sunday a month along the River Seine and created about 30 miles of cycle lanes during the pandemic alone.

Zurich

Switzerland doesn't have much land, so it has had to be thoughtful about urban planning for a long time. In the city core, there are few private automobiles, and most people get around by foot or bicycle.

Barcelona

In the past three years, Barcelona has converted around 20 acres of streets into sidewalks, playgrounds, bike lanes, or restaurant terraces, according to the World Economic Forum. Most of these are concentrated in "superblocks" — four-square-block areas that now permit only pedestrians and delivery vans.

Vienna

Residents of Vienna make 28% of their daily trips on foot, and there are about 1,000 miles of bicycle paths, according to the city's official website. Like Zurich, Vienna appears consistently at the top of quality of living rankings, in part because of its walkability.

Portland

An early adopter of 15-minute principles, Portland, Ore. created its long-range plan to evolve into a more livable city in 2012. Every aspect of urban life — housing, employment, health effects, connectivity, mobility, economy, and education — is considered in the plan. A key part of the blueprint focuses on "neighborhood centers" across the metropolitan area.

Melbourne, Australia and **Milan, Italy** also are implementing 15-minute strategies, while U.S. cities with the greatest potential to achieve the goals include **Boston, Miami, Pittsburgh, San Francisco**, and **Washington, D.C.**, according to relocation technology company moveBuddha.

"If you look at headquarters for many big tech companies, they're in cities like Portland or Seattle. ... Both employers and employees stand to gain from this type of environment."

—Francisco Alaniz Uribe

some larger businesses have already located their offices in such areas. "If you look at headquarters for many big tech companies, they're in cities like Portland or Seattle," he says. "Google has a large office in Zurich, and Vienna is another IT hot spot. Both employers and employees stand to gain from this type of environment."

And while Alaniz points out businesses may need to adapt some of their practices to the 15-minute city, those adaptations can come with benefits, too. For example, walkable neighborhoods tend to have more grocery stores, he says, but they are not the huge supermarkets common in suburbs. Having more, but smaller, stores could require retailers to recalibrate their business models, catering to residents in a more targeted way — and that can raise their brand profiles, and profitability, in those neighborhoods.

Existing 15-minute cities tend to support vibrant local business communities, creating opportunities for organizations to shorten supply chains by buying local. That reduces transportation costs and carbon emissions, and it also can bring access to specialized local expertise. But finding viable space for large offices in these walkable neighborhoods could prove difficult, as population density tends to drive up real estate costs. Larger companies might open neighborhood satellite offices to accommodate part-time occupancy by hybrid workers instead of having them drive to a main campus miles away.

Urban Planning Hurdles

While Vienna and Zurich have succeeded by applying 15-minute principles incrementally over decades, cities at the beginning of that journey may have significant barriers to overcome. First, zoning is at the heart of many issues walkable cities seek to address. For the 15-minute city to work, higher densities are necessary.

Regulations that restrict density and those that strictly segregate land use between commercial and residential may need to be revisited. Mixed-use development, which combines residential and commercial space in the same location, can be part of the solution.

Second, setting urban boundaries where development will be allowed and sticking to them is key. "Landowners need to participate in that conversation, because they may see it as a negative," Alaniz says. Greenfields outside these new boundaries — especially undeveloped tracts adjacent to urban areas held by developers for future development — could lose value. "We continue to make it easy to build in the suburbs, and that's competing with the 15-minute city concept," he adds.

Third, significant public investment may be required. Alaniz points out that many cities were originally planned with an emphasis on cars rather than pedestrians, often resulting in narrow sidewalks and dangerous intersections to cross on foot.

Finally, cities need effective and accessible mass transit to move people longer distances. Here, Alaniz sees an opportunity for businesses to partner with local government. "Sometimes private sector companies will pay for the extension of a tram or streetcar to better connect with their development, and later the city will take over operation of the line," he says.

Building on a Walkable Foundation

Existing neighborhoods in urban areas are often the best candidates to begin implementing 15-minute principles. "Here in Calgary, we used to have a streetcar system, and those former streetcar routes are the bones of a walkable community where there's a mix of land usage," he says. However, areas in the urban core, especially if they have been redeveloped, can be expensive for residents and businesses.

One solution may lie in redeveloping office buildings emptied out by the pandemic — particularly in the U.S., where barriers to 15-minute city development can be substantial. Vacancy rates for U.S. commercial buildings are high: 17.9% nationwide and reaching almost 30% in San Francisco, according to real estate firm CBRE. In New York, which has a 15.5% vacancy rate, Mayor Eric Adams announced a plan to convert empty offices to 500,000 new homes. Parts of midtown Manhattan that currently allow only offices or manufacturing spaces will be rezoned to allow mixed use. Adams says some of those new homes would be rent-restricted, to keep them affordable. While office-to-residential conversions can be expensive, the right zoning reforms, municipal support, and strategic planning could make such projects more feasible in other metropolitan areas as well.

A Potential Tipping Point

A century after it was first conceptualized by urban planner Clarence Perry, the idea of the walkable neighborhood may finally be poised to fulfill its promise. As with many big changes, it may happen more by necessity than by choice. The need for businesses to locate in areas attractive to young, skilled workers and the desire of many people to live where they can walk to the grocery store, the park, and the pub might pave the way for 15-minute cities to thrive.

David Salierno is managing partner at Nexus Content in Winter Park, Fla.


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Human Factors

With organizations still struggling to fill roles, talent management risk is a puzzle to solve.

Dawn Jones
Risk & Financial Advisory
Managing Director,
Internal Audit, Deloitte

How do organizations view talent management risk?

Outside of organizations where "people are the product," most have not given much thought to talent management when weighing enterprise risks. Historically, talent management risk considerations have been more narrowly focused on immediate concerns: succession planning for leaders, the financial and operational impacts of employee turnover, and employee safety. Rarely were they a source of discussion beyond the organization's human resource function.

However, in a post-pandemic world with workforce dynamics shifting, talent management risks are now part of the conversation at the executive leadership and board levels, as talent management becomes more of a strategic focus. C-suites and boards are now recognizing the importance of including these risks when making workforce decisions, and risk management functions are beginning to incorporate talent management in their risk discussions.

What factors contribute to talent management risk?

Traditional talent management risks — sourcing, attracting, developing, and retaining talent — are still important. However, employee expectations about when they work, where they work, and their development opportunities have shifted post-pandemic. In parallel, employees also have a greater desire for their employer's values to align with their own. Employees may look at the actions their organization takes to create a diverse and inclusive culture, whether it is positively impacting the greater society and environment, and whether the organization is considerate of individual well-being. These factors have created or evolved risks for organizations.

In response, it has become increasingly important for organizational enterprise risk frameworks to be more holistic and expansive, recognizing external risk factors within the technological, environmental, social, economic, and geopolitical landscape that are driving today's talent management risks. Organizational risk frameworks also must account for the future of work and the changes in the "what, where, and how" of work.

How does the ability to manage this risk affect other risks?

In today's world, nearly all enterprise risks have a human element. Technology risks already have a significant impact on the workforce — and those implications will continue to grow as we consider how technology influences how work gets done.

Environmental and climate risks could impact how and where work gets performed, and where that workforce is located. Social risks can impact how employees feel about the organization and their work, as well as their sense of belonging.

None of these risks occur in silos, and their interrelated nature and impacts must be considered in assessing priority and mitigation response to talent management. Doing so is not just a risk imperative, but also a business imperative.

Today, it is about operational performance and having a competitive advantage in terms of talent. Looking out further, it may be the organization's preparedness to continue to exist.

In today's world, nearly all enterprise risks have a human element.

Mike Monahan
Principal,
Grant Thornton

How can organizations expand their talent pool?

Organizations and entire industries need to challenge the traditional paradigms of what "skills" and "licenses" are foundationally necessary to deliver success. They need to look beyond a limited number of majors, credentials, or specific schools and instead prioritize skills, determination, and the willingness to learn. Nontraditional recruiting approaches, such as through community college pipelines, veteran advocacy organizations, and organizations focused on neurodivergent candidates can be essential pathways to finding unique talent.

In the search for talent, it is important to examine the organization's current approaches and reflect honestly on existing barriers. For example, do academic expectations accurately reflect the performance needed to be successful? Are hiring managers willing to listen to someone's story about how they got to where they are — rather than simply deploying technology that filters out talented people who could bring unique experience to the team? Organizations also must consider who is doing their recruiting and ascertain if recruiters are in line with the organization's objectives for finding talent.

What strategies help organizations recruit top talent?

Forward-thinking organizations are beginning the recruiting process earlier, marketing internal auditing to people who might not otherwise consider it. They are developing near-term and long-term objectives when it comes to attracting and retaining top talent — especially top diverse talent. By better understanding the preferences of target communities and conferring with diversity, equity, and inclusion experts, firms can fine-tune messages that resonate most with job candidates.

Recruiting globally or offering remote workforce options also can increase recruiting competitiveness. This requires organizations to be practiced in the technical and legal challenges of recruiting abroad and remotely. Moreover, organizations should ensure that the new hire experience of global colleagues focuses on more than just helping them move locations. To ensure a solid integration into the business, organizations should help workers incorporate into the community where they will live and work.

What strategies help retain employees?

While attrition rates are falling in some industries, others are not as lucky. Listening sessions can be a key ingredient in an organization's efforts to enhance retention and care for its people. These discussions can lead an organization to redesign its benefits, programs, and reward approaches — focusing them on where professionals are in their personal lives. Some examples might be expanded mental healthcare offerings, childcare or elder care backup support, online tutoring services for working parents, and adult education offerings beyond traditional classroom subjects.

One critical element to help retain talent in the post-COVID workplace is personal connectedness. Organizations need to recognize that staying connected in a virtual environment is difficult, and leaders need to make connectivity a priority.

Organizations can do this by redefining the physical workspace into one that isn't just a place of work, but rather a space to connect and come together. Ultimately, innovative strategies boil down to time and whether organizations are willing to put in the time to commit to attracting, retaining, and motivating the people who truly make their business successful.

Forward-thinking organizations are beginning the recruiting process earlier, marketing internal auditing to people who might not otherwise consider it.


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Over the years, I have struggled to find a hobby and stick with it. From crocheting to making dresses for my friends, I would always lose interest because I could not find the time to build my skills.

During the COVID-19 pandemic I had some time, and I was asked to bake a cake for my sister's birthday. I was nervous, as I am a perfectionist — and I was hopeless at baking. I could never get the ingredients and temperature right. However, I like to be challenged. In my internal auditor work, I always face challenging tasks, so I didn't let my fear of failing stop me.

Since that day, my baking skills and creativity have greatly improved. I enjoy the therapeutic benefits of baking cakes, scones, and dinner rolls. While experimenting, I discovered a secret ingredient for my scones, which is what my family and friends like best. My dream now is to open a bakery called The Cakes Corner.

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