Developing a 2025 Strategic Plan of the Internal Audit Function

Kristiina Lagerstedt
VP, Audit & Assurance @Sanoma
Board member @ECIIA
Board member @Uutechnic Group Plc (Nasdaq Helsinki)
1. Making assurance relevant to the Board and Top Management
2. Siloed vs combined functions, 3 lines of defense
3. Should Internal Audit lead the change?
What is the role of Internal Audit & Assurance

- Board and the management needs to know what is happening in the various areas of the business – and to have the trust that business operations/ actions are heading the right way.

- **Compliance** activities ensure the right guidance is in place and it is adequately implemented (training).

- A good **Internal control** framework assures that the laws and company policies/ standards are being followed, the authorization limits are adhered to and no surprises arise from the businesses. Internal control is responsibility of the board and CEO (the business, 1st LoD), Internal Audit & Assurance can help in implementing and monitoring this activity; and in maintaining the Internal Control Framework.

- Reporting is the way for the management and board to follow if the business operations/ actions are successful (Financial reporting + KPI’s for strategic goals). Effective Internal controls ensure that the financial reporting is correct.
What is the role of Internal Audit & Assurance

- **Risk management** facilitates a process to identify, prioritize & manage the main risks. Board and CEO is ultimately responsible for risk in their organizations.

- **Investigative activities** occur when issues have arisen from a whistleblower channel or from an Internal audit or other channels (Ethics & Compliance/ Security/ Internal audit). There needs to be a way to have corrective actions to change controls/ or have adequate monitoring to prevent similar issues in the future.

- The **Internal audit** activities are conducted to check processes/ issues that are of higher importance to the management or has greater impact from shareholder value perspective - or areas where lack of controls or incidents of fraud are identified. Internal audit can also have the lead in investigation activities where it can work in close cooperation with Compliance/ Security.

- **External audit** provides assurance that the financial statements give a true and fair view.
Board and top management expectations from Internal Audit and Assurance

Assurance on:
- Execution of **strategy**
- Provide a view on significant **risks** + emerging risks and the mitigation of those
- Adherence to external and internal **regulation** (laws and policies)
- Monitoring and Financial reporting

=> Assurance that the right things are done

**Doing the right things right**
1. Making assurance relevant to the Board and Top Management

2. Siloed vs combined functions, 3 lines of defense

3. Should Internal Audit lead the change?
History of Assurance Functions and Internal Audit

- **1941 IIA formed**
- **1977: FCPA**
- **1980’s: Increased focus on controls and compliance in Financial industry**
- **1992: COSO Internal control - Integrated framework**
- **2002 SOX**
- **2004 release of COSO ERM Integrated framework**

SILOED DEVELOPMENT OF INTERNAL AUDIT, RISK MANAGEMENT, INTERNAL CONTROLS, COMPLIANCE ETC.
Second line of defense and internal audit

- Understanding role and responsibility for each separate function (Internal Controls, Compliance, Risk Management, Internal Audit and also External Audit) is a challenge to directors serving on the Board of Directors.
- Three lines of defense model makes this more clear but on high level.
- In worst cases the siloed functions use a lot of time between themselves to argue about their roles and responsibilities.
- From Board and Top Management perspective it does not matter who does it, but they want it to be done in a systematic and clear way.
Current Guidance from IIA related to second line of defense tasks

- The key question is if the Internal Audit Function can work independently and objectively if support is provided on areas relating to Risk Management, Compliance and Internal Controls.

- Combining the Internal Audit and second line of defense functions is not the preferred solution from the perspective of the three lines of defense model and the auditor’s independence and objectivity.

- Need to consider what is the best way to operate – this depends on
  - 1) what business(es) the company operates in and how regulated those are
  - 2) what countries the company operates in
  - 3) what is the maturity of the assurance related processes and
  - 4) the quality of the resources

---

### Basic conditions and safeguards

<table>
<thead>
<tr>
<th>Overarching basic conditions and safeguards</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Effectiveness not to be compromised:</strong> lines of defense should not be combined or coordinated in a manner that compromises their effectiveness with respect to providing independent and objective assurance.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Subsequent basic conditions and safeguards</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Make consequences explicit:</strong> Internal Audit should clearly communicate the impact of the combination to senior management and the governing bodies (and obtain their approval).</td>
</tr>
<tr>
<td><strong>No management responsibility:</strong> Internal Audit should not assume any managerial responsibilities with respect to the audit object. The IAF can facilitate and support, but should never assume ownership.</td>
</tr>
<tr>
<td><strong>Formalize:</strong> roles and responsibilities are to be described in the audit charter in order to avoid ambiguity and provide clarity in the organization.</td>
</tr>
<tr>
<td><strong>Maturity:</strong> in case of a temporary role in which Internal Audit supports the setup of second line of defense functions or design of methodology, the approach is to be approved by the AC.</td>
</tr>
<tr>
<td><strong>Outsourcing:</strong> if Internal Audit is involved in second line of defense activities, the task of providing objective assurance regarding these specific activities will have to be outsourced, either externally or internally to other departments.</td>
</tr>
<tr>
<td><strong>Segregation of duties:</strong> potentially conflicting roles are to be allocated to different individuals and/or (sub-)departments.</td>
</tr>
</tbody>
</table>

---

Agenda

1. Making assurance relevant to the Board and Top Management

2. Siloed vs combined functions, 3 lines of defense model

3. Should Internal Audit lead the change?
Internal audit vs 2nd Line of Defense functions

- In 3 LoD model Internal audit is expected to audit the 2nd LoD functions
- 2nd LoD functions does not have ownership of the areas where they provide help to the business (Risk and Controls)
- The target for ALL of these functions is same – to provide assurance on Doing the right things
- When having less resources, the doing of Internal controls and Risk management should be pushed to where ownership belongs – to the 1st LoD, and to also audit these activities on that level
- This approach provides Internal audit (or Assurance functions, whatever you call it) to focus on more important areas and to deliver greater value to Board and Top Management
Internal audit

Internal audit definition
Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

Internal audit mission
To enhance and protect organizational value by providing risk-based and objective assurance, advice, and insight.
Core Principles for the Professional Practice of Internal Auditing

- Demonstrates integrity.
- Demonstrates competence and due professional care.
- Is objective and free from undue influence (independent).
- Aligns with the strategies, objectives, and risks of the organization.
- Is appropriately positioned and adequately resourced.
- Demonstrates quality and continuous improvement.
- Communicates effectively.
- Provides risk-based assurance.
- Is insightful, proactive, and future-focused.
- Promotes organizational improvement.
Internal audit (or Assurance Functions) in 2025

- Coordinates or leads the work of separate assurance functions
- Based on a Company risk assessment Internal audit and Assurance functions can be integrated in some cases
- Coordinated/ joint development of Assurance
- Focus on Big Digit items from Strategy, Risk or Board/ Top Management perspective to grow or protect shareholder value
IIA Position Paper: THE THREE LINES OF DEFENSE IN EFFECTIVE RISK MANAGEMENT AND CONTROL - JANUARY 2013


..........................

Upcoming changes to International Standards for the Professional Practice of Internal Auditing