



ADDING VALUE WITH RISK BASED AUDITING

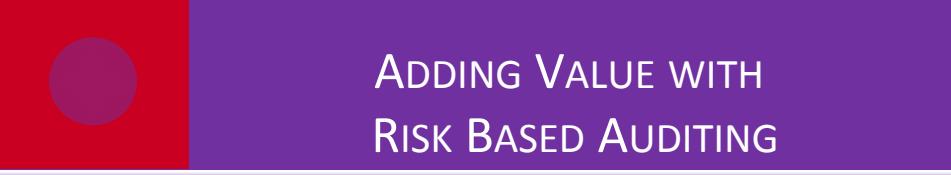
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ADDING VALUE WITH RISK BASED AUDITING

IN THIS PRESENTATION YOU WILL LEARN:

- How to Focus Audits in Ways that Help the Organization be Successful;
- How to Assess the Value IA Provides the Organization;
- How to Significantly Improve the Likelihood that IA's Recommendations are Implemented;
- What Initial Steps will Move IA towards this Risk Based Approach.

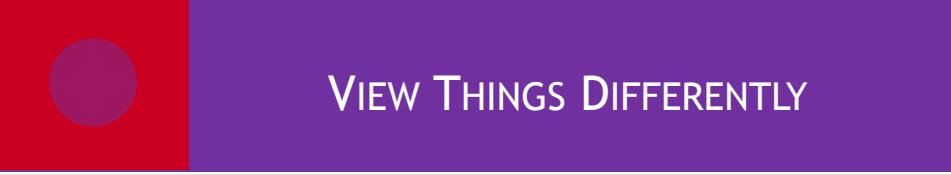
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ADDING VALUE WITH RISK BASED AUDITING

- ❖ **V**iew Things Differently
- ❖ **A**sess Your Value
- ❖ **L**isten To Your Customer
- ❖ **U**tilize Resources Effectively
- ❖ **E**nvision Your Team's Future

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VIEW THINGS DIFFERENTLY

“Insanity: doing the same thing over and over again and expecting different results.”

– Albert Einstein

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VIEW THINGS DIFFERENTLY

A View of an Organization From a Control Perspective

GOVERNANCE : Governing Board Members/ Agency Executives/ Division Directors Role: Oversight - strategy / goal setting; risks/ risk limits approval & monitoring	ASSURANCE Internal Auditors External auditors Quality Assurance Role: Provide Assurance regarding the effectiveness of GOVERNANCE, MANAGEMENT & PERFORMANCE functions
MANAGEMENT: Department / Process / Project Managers Role: Deployment and monitoring of resources to accomplish business objectives	
PERFORMANCE: Front Line Supervisors Role: Day-to-day processes, operations, & project activities	

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VIEW THINGS DIFFERENTLY

What HUGE advantage does Internal Audit have that no other department has in an organization?

Answer:
No one understands WHAT you do and they FEAR what you will report about them!



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VIEW THINGS DIFFERENTLY

**Although No one understands WHAT you do,
Agency Executives DO CARE about:**

What you DELIVER for the \$\$\$ you consume!



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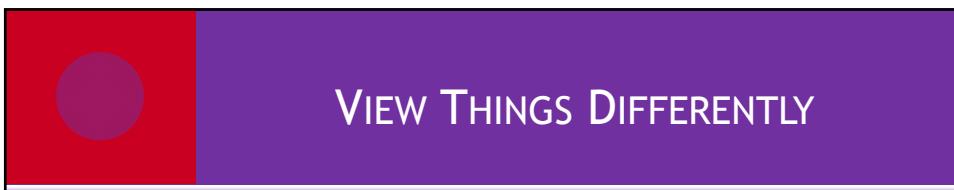
VIEW THINGS DIFFERENTLY

How Is Your Audit Team Viewed By Your Customer?

- Favorable? Only tolerated? Indifferent?
- What impact do your audit reports have?
- Would you like to be audited by your team?
- Could you reasonably implement your team's recommendations?



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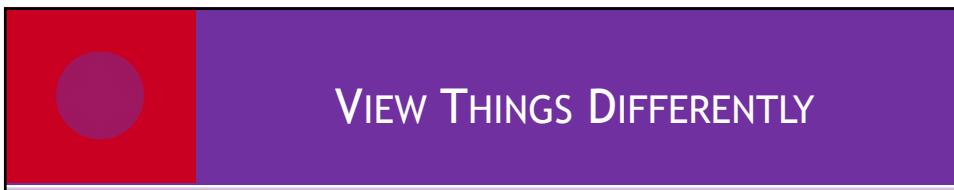


VIEW THINGS DIFFERENTLY

How Do You Define Risk?

The chance of something happening
that WILL have an impact on
Business Objectives.

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VIEW THINGS DIFFERENTLY

Simply said...

Risk = *Things Go Wrong*

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VIEW THINGS DIFFERENTLY

Can You Eliminate Risk?

*Business Is
The Art Of Taking Risks!*

The illustration shows two identical blue seesaws. On the left seesaw, there is a large stack of green dollar bills on one end and a small stack on the other, labeled 'HIGH RISK' in red. On the right seesaw, there is a small stack of green dollar bills on one end and a larger stack on the other, labeled 'LOW RISK' in blue. This visual metaphor represents that taking risks can lead to both high and low outcomes.

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VIEW THINGS DIFFERENTLY

When auditors “write people up” for “things going wrong”, what message is being sent?

Obvious Answer:

Nothing should ever go wrong!

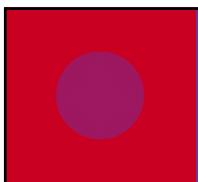
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VIEW THINGS DIFFERENTLY

When auditors “write people up”
because of potential risk,
Internal Audit is setting
the *defacto risk appetite*
of the company!

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VIEW THINGS DIFFERENTLY

How Do You Define Internal Controls?

Internal Control can be loosely defined as:

What management does to ensure
things that are supposed to happen, do happen, and
things that are not supposed to happen, do not happen.

What management does = **Controls**
Things that are supposed to happen = **Business Objectives**
Things that are not supposed to happen = **Risk**

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VIEW THINGS DIFFERENTLY

How do we know that the amount of control is adequate?

Common ❖ Nothing ever goes wrong
Answers: ❖ Audit didn't find anything

*Business is
The Art of Taking Risks!*



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VIEW THINGS DIFFERENTLY

What is the Right Level of Control?

It Depends...

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VIEW THINGS DIFFERENTLY

It Depends on:

Business Objectives

→ Risk & How Much Risk
(Limits of Risk)

→ Controls

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```
graph TD; A[Any Statement about  
In Isolation of the] --> B[Controls]; B --> C[Business Risk &  
Limits of Risk]; C --> D[In Isolation of the  
Business Objectives]; E["Is meaningless and adds NO VALUE!"]
```

VIEW THINGS DIFFERENTLY

Any Statement about
In Isolation of the

Controls

Business Risk &
Limits of Risk

In Isolation of the
Business Objectives

Is meaningless and adds NO VALUE!

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VIEW THINGS DIFFERENTLY

Things WILL Go Wrong



So...How much RISK are we prepared to live with?

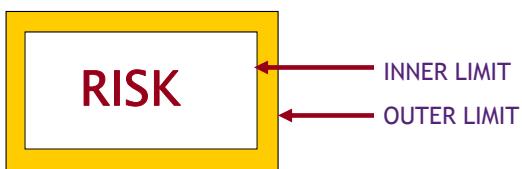
**Given Our Scarce Resources
&
Demands On Those Resources**

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VIEW THINGS DIFFERENTLY

How Much Risk Are We Prepared to Live With?

Auditors Must Understand: Until the **Limits of Risk** are identified, the audit team will not know whether the **RISK** is over-controlled or under-controlled.



Limits are Determined through Discussions with Those Accountable for the Success of the Business Function.

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VIEW THINGS DIFFERENTLY

The figure consists of three separate line graphs, each with 'Risk' on the vertical axis and 'Time' on the horizontal axis. Each graph features two dashed horizontal lines representing 'Limits'. A wavy purple line represents the actual risk over time.

- Top Graph:** The purple line stays between the upper and lower limit lines. A yellow smiley face emoji with a question mark is positioned above the line near the top limit, indicating the risk is within acceptable bounds.
- Middle Graph:** The purple line starts between the limits, goes above the upper limit (reaching a yellow smiley face emoji labeled 'Good News'), then drops back below the lower limit (reaching a yellow sad face emoji labeled 'Bad News'). It then fluctuates between the limits. This indicates the risk moved outside the approved limits but was corrected.
- Bottom Graph:** The purple line consistently stays above the upper limit, reaching a yellow sad face emoji labeled 'Bad News'. This indicates the risk has been moving outside the approved limits and is not being addressed.

Business risk is within Governance approved limits.

Business risks moves out of approved limits (things go wrong) but corrective action is taken to bring the risk back within Governance approved limits.

Business risk starts moving outside Governance approved limits of risk and it is not being addressed.

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VIEW THINGS DIFFERENTLY

Determining Limits Of Risk Is Not Easy!

DO NOT

- ❖ Directly ask audit customers “What are your limits?”

DO

- ❖ Talk in terms they understand
- ❖ Emphasize cost/benefit tradeoffs
- ❖ Emphasize need to reduce costs in changing competitive environments
- ❖ Understand their continuous improvement **QUALITY** metrics

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VIEW THINGS DIFFERENTLY

NEVER FORGET: CONTROLS COST MONEY!

The only reason for control is to help people be successful
in accomplishing their

Business Success Objectives



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ADDING VALUE WITH RISK BASED AUDITING

- ❖ **View Things Differently**
- ❖ **Assess Your Value**
- ❖ **Listen To Your Customer**
- ❖ **Utilize Resources Effectively**
- ❖ **Envision Your Team's Future**

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ASSESS YOUR VALUE

Successful Organizations Understand:
Value is ALWAYS Determined by the Customer.

Applied to Internal Auditing:

Audit Value is ALWAYS determined by the
Audit Customer, NOT by Internal Auditing

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ASSESS YOUR VALUE

KNOW WHO YOUR AUDIT CUSTOMER IS

ALWAYS Senior Executives
Governing Board Members/ Agency Executives/ Division Directors

**GOVERNANCE : Governing Board Members/ Agency
Executives/ Division Directors**
Role: Oversight - strategy / goal setting; risks/ risk limits
approval & monitoring

NEVER Middle Management

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ASSESS YOUR VALUE

CAEs believe if their audit committee/executive management were surveyed today on *how well IA meets their needs & expectations*, they would probably rate their overall satisfaction as:

	Audit Committee	Executive Mgt
Unacceptable	0.0%	0.4%
Poor	.04%	1.9%
Acceptable	16.1%	25.9%
Good	57.6%	57.8%
Outstanding	25.9%	14.0%

Source: Emerging Trends and Leading Practices Spring 2011, The Institute of Internal Auditors – Audit Executive Network

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ASSESS YOUR VALUE

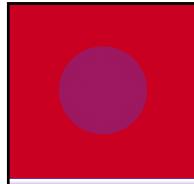
Audit Committee/ Executive Management Feedback

- 74% believe Internal audit *needs improvement*
- 96% believe that improvement needs to be accomplished *within the next 24 months*
- 56% do *not* believe Internal Audit helps achieve business objectives
- 63% do *not* involve Internal Audit in key business decisions and strategy
- 68% do *not* believe Internal Audit attracts future leaders and high potential talent from within the business

Source: Ernst and Young global internal audit stakeholder survey, November 2010.

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ASSESS YOUR VALUE



What do Customers Value?

Information that helps them
manage risks that they are concerned about
 & that threaten their ability to be successful!

Info that helps them meet their business objectives!

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ASSESS YOUR VALUE



Factors Behind Rapid Loss in Shareholder Value

Factor	Percentage
Strategic & Business	60%
Operational	20%
Financial	15%
Compliance	5%

■ Strategic & Business
 ■ Operational
 □ Financial
 ■ Compliance

Source: An opportunity for transformation* How internal audit helps contribute to shareholder value, PricewaterhouseCoopers , Oct.2008

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ASSESS YOUR VALUE

2012 TOP 10 OPPORTUNITIES - GOVERNMENT AND PUBLIC SECTOR

	Opportunity	Area of Impact
1	Strengthen new forms of global governance	Stakeholder Confidence
2	Overhauling financial sector regulation	Stakeholder Confidence
3	Reviewing core purpose of government	Stakeholder Confidence
4	Driving Change through IT	Operational Agility
5	Developing new delivery models	Customer Reach
6	Increasing public-private partnership	Cost Competitiveness
7	Encouraging Industrial policy in leading-edge sectors	Stakeholder Confidence
8	Rethinking regional and urban development	Stakeholder Confidence
9	Promoting and enhancing of SCR practice for alternative public services and delivery models	Operational Agility
10	Enhancing the role of the government in the economy	Stakeholder Confidence

Source: **Turn Risks And Opportunities Into Results:** Exploring the top 10 risks and opportunities for global organizations by Ernst & Young
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ASSESS YOUR VALUE

“What do Audit Customers Value?”

CUSTOMER

- ✚ CONTENT
- ✚ UNDERSTANDABILITY
- ✚ TIME
- ✚ COST

COMPONENTS OF AUDIT VALUE

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ASSESS YOUR VALUE



CUSTOMER

Have we identified the correct AUDIT CUSTOMER ?

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ASSESS YOUR VALUE



CONTENT

How does the Content of this audit report help make the Audit Customer **successful** in accomplishing their *Business Objectives* ?

“SO WHAT?”

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ASSESS YOUR VALUE

?

UNDERSTANDABILITY

Is the *Linkage* to their *success* readily apparent to the Audit Customer?

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ASSESS YOUR VALUE

hourglass

TIME

- ❖ Will the audit report help them meet their success objectives or is it too late?
- ❖ Are we delivering the report when we committed to deliver it?

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ASSESS YOUR VALUE



COST

- ❖ Is value evident in the report greater than the cost of the audit?
- ❖ Does it cost what we committed it would cost?

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ASSESS YOUR VALUE

Components of Audit Value

CUSTOMER

+ CONTENT *

+ UNDERSTANDABILITY

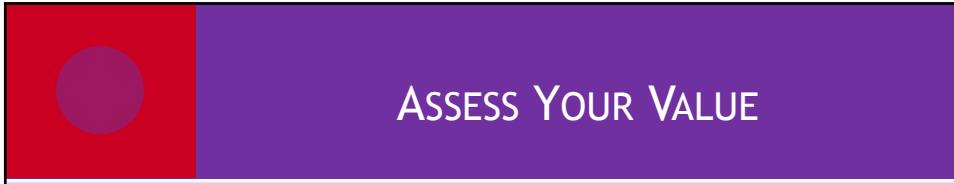
+ TIME

+ COST *

TEST EVERY AUDIT REPORT/PRESENTATION AGAINST
THE 5 COMPONENTS OF AUDIT VALUE!

**The most important components of audit value are cost and content.*

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ASSESS YOUR VALUE

Survey Audit Customer After Every Audit

"This audit cost the stockholders \$xxx (actual cost/ blended rate/travel expenses). Did you see value greater than this cost in the results of the audit?

Yes / No

If No, why not? _____

Other comments you would like to share:

_____ "

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LISTEN TO YOUR CUSTOMER

YOU CANNOT COVER EVERY RISK!

There Are Simply Not Enough Auditors To Appraise Every Possible Risk.

SELECT RISKS TO APPRAISE BASED ON:

- Key concerns of Audit Customer (Executives)
- Key concerns of Audit Committee
- Other risk appraisal efforts underway
- Past history - fraud areas, loss areas, problem areas

SUCH THAT: THERE IS MAXIMUM VALUE TO AUDIT CUSTOMER FOR MINIMAL COST

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LISTEN TO YOUR CUSTOMER

2-STEP RISK ASSESSMENT

Step 1- Strategic (Big Picture) Risk Assessment

Interviews with Business Function Executives to Identify Business Risks

Risks and Audit Strategy Document (Audit Plan)

Audit Executive

Chief Audit Executive

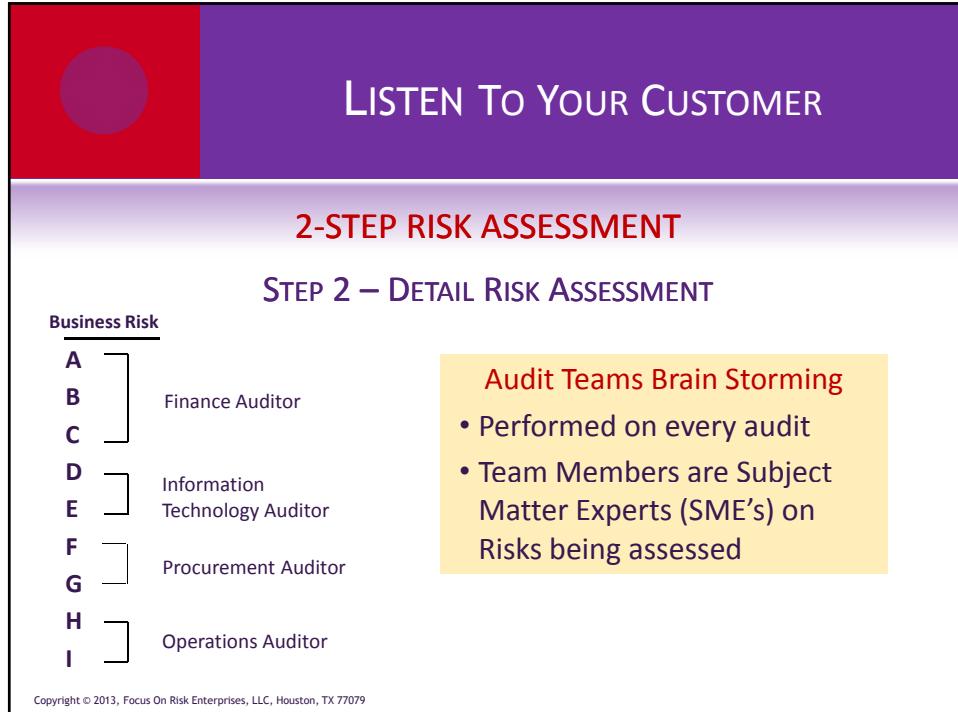
AUDIT COMMITTEE

Monthly Discussions Between Audit Customer & Audit Executive

- Customer brings their issues to table
- Audit Executive brings their issues to table
- Ongoing – at every meeting (at least monthly)
- Audit Executives use information to prioritize audits

Risks are constantly changing. Risk Assessment should be constant – not an annual, stand alone exercise.

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LISTEN TO YOUR CUSTOMER

2-STEP RISK ASSESSMENT

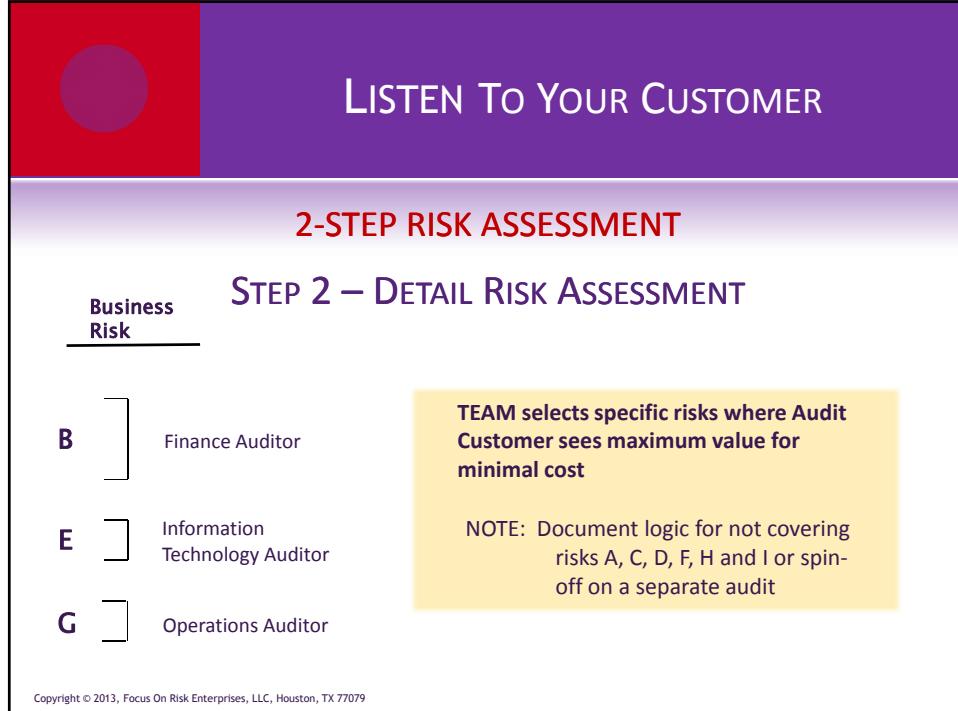
STEP 2 – DETAIL RISK ASSESSMENT

Business Risk	
A	Finance Auditor
B	Information Technology Auditor
C	Procurement Auditor
D	Operations Auditor
E	
F	
G	
H	
I	

Audit Teams Brain Storming

- Performed on every audit
- Team Members are Subject Matter Experts (SME's) on Risks being assessed

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LISTEN TO YOUR CUSTOMER

2-STEP RISK ASSESSMENT

STEP 2 – DETAIL RISK ASSESSMENT

Business Risk	
B	Finance Auditor
E	Information Technology Auditor
G	Operations Auditor

TEAM selects specific risks where Audit Customer sees maximum value for minimal cost

NOTE: Document logic for not covering risks A, C, D, F, H and I or spin-off on a separate audit

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LISTEN TO YOUR CUSTOMER

Rolling 12 Month Audit Plan

FOR AUDIT COMMITTEE APPROVAL

```

graph TD
    A[Top of the House Requests  
Front End  
Cover the Basics  
Continuous Auditing/Monitoring] --> D[Risks and Audit Strategy Document*  
(Audit Plan)]
    D --> B[Audit Executive]
    D --> C[Audit Executive]
    D --> E[Audit Executive]
    D --> F[Chief Audit Executive]
    B --> D
    C --> D
    E --> D
    F --> D
    B --> G[AUDIT COMMITTEE]
    C --> G
    E --> G
    F --> G
    G --> D
    
```

*Risks assessed & prioritized by Audit Executives at least quarterly

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LISTEN TO YOUR CUSTOMER

Rolling 12 Month Audit Plan

FOR AUDIT COMMITTEE APPROVAL

Top of the House Requests

- ❖ Requests from audit customers – always a top priority

Front End

- ❖ Requests for up-front involvement in major process and systems initiatives

Cover the Basics

- ❖ Address basic financial, compliance, and asset protection internal control risks including basic information technology risks

Continuous Auditing/Monitoring

- ❖ Use technology to monitor risks / controls 24 hours a day

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LISTEN TO YOUR CUSTOMER

ROLLING 12 MONTH AUDIT PLAN FOR AUDIT COMMITTEE APPROVAL

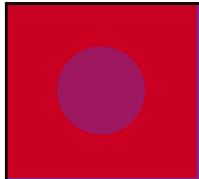
ROLLING 2nd QUARTER AUDIT PLAN FY 2013:

JAN	FEB	MARCH	APRIL	MAY	JUNE	JULY	AUG	SEPT	OCT	NOV	DEC
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<div style="border: 1px solid red; padding: 5px; margin-bottom: 5px;">013454 – UNRELIABLE BUSINESS CASES</div> <div style="border: 1px solid black; padding: 5px; background-color: #f0f0f0;">1/2/2013 Business Cases Process Review</div>	<div style="border: 1px solid black; padding: 5px; background-color: #f0f0f0;">013455 – UNAUTHORIZED ACCESS</div> <div style="border: 1px solid black; padding: 5px; background-color: #f0f0f0;">4/1/2013 IT User Profile Review</div>	<div style="border: 1px solid black; padding: 5px; background-color: #f0f0f0;">013457 – TALENT MANAGEMENT CONSULTING PROJECT</div>	<div style="border: 1px solid black; padding: 5px; background-color: #ffffcc;">013459 – SPECIAL PROJECT 4TH QUARTER</div>	
<div style="border: 1px solid black; padding: 5px; background-color: #f0f0f0;">013456 – INEFFECTIVE ACCTG CONTROLS</div> <div style="border: 1px solid black; padding: 5px; background-color: #f0f0f0;">4/1/2013 Assess Basic Accounting Controls In Aurora Office</div>	<div style="border: 1px solid black; padding: 5px; background-color: #f0f0f0;">013458- LOST REVENUES</div>			

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LISTEN TO YOUR CUSTOMER

ROLLING 12 MONTH AUDIT PLAN FOR AUDIT COMMITTEE APPROVAL

ROLLING 3rd QUARTER AUDIT PLAN FY 2013:

JAN	FEB	MARCH	APRIL	MAY	JUNE	JULY	AUG	SEPT	OCT	NOV	DEC
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<div style="border: 1px solid red; padding: 5px; margin-bottom: 5px;">013454 – UNRELIABLE BUSINESS CASES</div> <div style="border: 1px solid black; padding: 5px; background-color: #f0f0f0;">1/2/2013 Business Cases Process Review</div>	<div style="border: 1px solid black; padding: 5px; background-color: #f0f0f0;">013455 – UNAUTHORIZED ACCESS</div> <div style="border: 1px solid black; padding: 5px; background-color: #f0f0f0;">4/1/2013 IT User Profile Review</div>	<div style="border: 1px solid black; padding: 5px; background-color: #ffffcc;">013459 – SPECIAL PROJECT 3RD & 4TH QUARTER</div> <div style="border: 1px solid black; padding: 5px; background-color: #ffffcc;">7/15/2013 Impact of Social Media</div>
<div style="border: 1px solid black; padding: 5px; background-color: #f0f0f0;">013456 – INEFFECTIVE ACCTG CONTROLS</div> <div style="border: 1px solid black; padding: 5px; background-color: #f0f0f0;">4/1/2013 Assess Basic Accounting Controls In Aurora Office</div>	<div style="border: 1px solid black; padding: 5px; background-color: #f0f0f0;">013457 – TALENT MANAGEMENT</div> <div style="border: 1px solid black; padding: 5px; background-color: #f0f0f0;">7/2/2013 Assess Impact of Retiring Baby Boomers</div>	<div style="border: 1px solid black; padding: 5px; background-color: #f0f0f0;">013458- LOST REVENUES</div>

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- ❖ **View Things Differently**
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UTILIZE RESOURCES EFFECTIVELY

“There is nothing so useless as doing efficiently that which should not be done at all.”

- Peter Drucker

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UTILIZE RESOURCES EFFECTIVELY

WHO IS RESPONSIBLE FOR CONTROLS?

MANAGEMENT!



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UTILIZE RESOURCES EFFECTIVELY

MANAGEMENT – IS RESPONSIBLE FOR:

- ✓ Their Staff
- ✓ Their Objectives
- ✓ Their Performance
- ✓ Their Technology
- ✓ Their Documentation



and for

THEIR CONTROLS!

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UTILIZE RESOURCES EFFECTIVELY

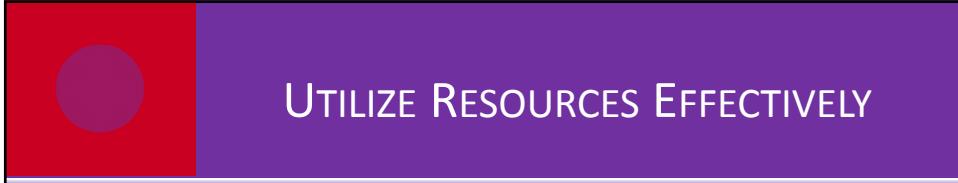
Management is responsible for internal controls in their department's processes and systems.

Two fundamental questions Management **MUST** be able to answer:

1. How do you know all your controls are working?
2. If they stopped working, would you know about it?

Put the onus for control back where it rightly belongs – Management!

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UTILIZE RESOURCES EFFECTIVELY

Unacceptable Answers:

- “I hire good people!”
(Don’t we all?)
- “I rely on Audit to tell me!”
 (“I’m a manager but I don’t have a clue!”)

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UTILIZE RESOURCES EFFECTIVELY

Two fundamental questions every Manager
MUST be able to answer:

- 1: How do YOU know that all your controls are working?
- 2: If they stopped working, would YOU know about it?

Management Control Structure

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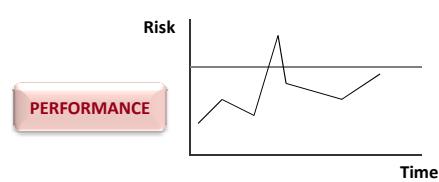
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UTILIZE RESOURCES EFFECTIVELY

Identifying Management's Control Structure

WHY?

- Understand how MANAGEMENT controls the risk
- Avoid spending costly audit resources reviewing an area that management has well controlled



Metrics and summary information that MANAGEMENT reviews and takes action on to know that all the detailed controls at the PERFORMANCE level are still working, and if they stopped working MANAGEMENT would know about it.

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UTILIZE RESOURCES EFFECTIVELY

Audit Standard: 2210.A3

Adequate criteria are needed to evaluate controls.

Internal auditors must ascertain the extent to which management has established *adequate criteria to determine whether objectives and goals have been accomplished.*

- If adequate, auditors must use such criteria in their evaluation.
- If inadequate, auditors must work with management to develop appropriate criteria.

Management Control Structure

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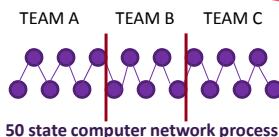
UTILIZE RESOURCES EFFECTIVELY

OBJECTIVE: 98.5% availability of computer network in each state, 24 hours/ day

Management Control Structure

consists of:

- Daily Operational meeting of team representatives
- Review of error logs & through put summaries
- Plot and monitor availability charts
- Decide on process improvement initiatives



- IT IS:
 - Easier
 - Faster
 - More Efficient
 - Less SME dependent

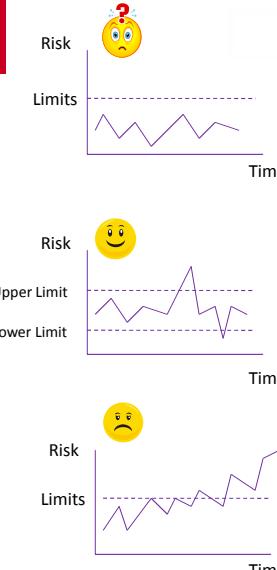
TO TEST THE MANAGEMENT CONTROL STRUCTURE

Than the detailed systems & processes

**TIME TO AUDIT = COST OF AUDIT,
TO INCREASE VALUE, REDUCE COST AT EVERY OPPORTUNITY**

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UTILIZE RESOURCES EFFECTIVELY



WHAT IS IA RESPONSIBLE FOR?

Assuring (by testing) that **MANAGEMENT** has established and is monitoring, metrics and indicators that prove that **RISK** is being managed to within **GOVERNANCE** approved limits.

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UTILIZE RESOURCES EFFECTIVELY

By Focusing on Management's Control Structure, the Audit Team may:

- Conclude that management has a structure in place to keep the risks within the acceptable limits. **Test to confirm, then STOP - move on to another risk.**
- Let management establish the control structure and review in, say, six (6) months. **STOP – move on to another risk.** (Some Audit Customers do not want recommendations from internal audit to fix their problems.)
- Offer to help management establish a control structure (Controls consulting).
- VP and AUDIT EXECUTIVE decide to partner on a consulting project to fix known problems at the PERFORMANCE (process) level.

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ADDING VALUE WITH RISK BASED AUDITING

- ❖ **View Things Differently**
- ❖ **Assess Your Value**
- ❖ **Listen to Your Customer**
- ❖ **Utilize Resources Effectively**
- ❖ **Envision Your Team's Future**

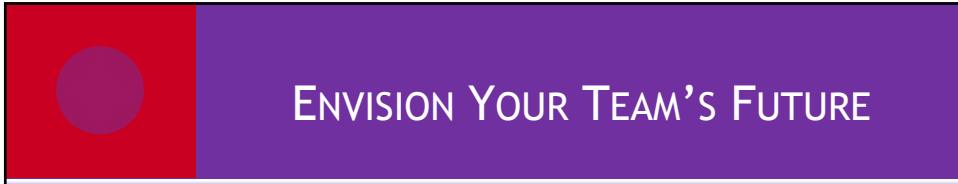
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ENVISION YOUR TEAM'S FUTURE

- What do you want your team to look like?
 - Vision
 - Objectives – Road Map
- Communicate – Communicate – Communicate
 - Audit Committee
 - Executive Director
 - Team

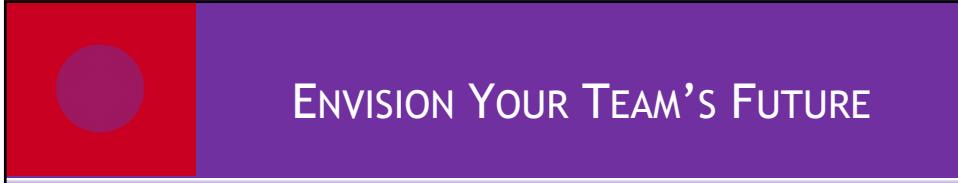
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ENVISION YOUR TEAM'S FUTURE

- Meet with Executives
 - What keeps them up at night?
 - How much risk are they willing to live with?
 - Set Expectations
- Educate your team & your organization
 - Business Objectives and Key Risks
 - Industry
- Constantly Assess & Then Take the Next Step

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ENVISION YOUR TEAM'S FUTURE

*“Continuous effort –
not strength or intelligence –
is the key to unlocking our potential”*
- Winston Churchill

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ADDING VALUE WITH RISK BASED AUDITING

- ❖ **V**iew Things Differently
- ❖ **A**ssess Your Value
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- ❖ **E**nvision Your Team's Future

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ADDING VALUE WITH RISK BASED AUDITING

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