

# 2022

## RISK IN FOCUS

Hot topics  
for internal  
auditors



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# INTRODUCTION:

## Auditing amid rapid change

**Organisations and their internal audit functions face a dizzying pace of change and unprecedented uncertainty. The pandemic has destabilised operations and labour, disrupted supply and demand, and undermined previously sound business models to an extent few would have thought possible.**

With the roll-out of vaccines in the developed world and the return of growth as economies reopened in 2021, it may be tempting to see the worst of the pandemic as having passed. However, COVID-19 will continue to have deep and lasting consequences, a new reality that organisations must accept.

Large sections of the workforce are reflecting on their futures, seeking new employment to advance careers stalled by the pandemic or changing course altogether by migrating into different sectors. Many countries are witnessing a resignation crisis, staff shortages and high vacancy rates demonstrating how profoundly the pandemic has exacerbated the talent management risks that existed long before 2020.

Workforce and labour market disruptions also have major implications for culture. CEOs are having to develop a clear vision for the future of their companies, and re-embed core values amid the transition to hybrid operating models that balance remote and on-site working arrangements. They must reconcile the shifting job expectations and new aspirations of existing and incoming staff with their corporate strategy and mission.

While the economic recovery is promising following the deepest global recession in living memory, businesses are contending with critical supply chain issues and inflation risks. Production costs have risen at a rate not seen for decades. Businesses are struggling to forecast demand for their products as virus infection rates and consumption continues to wax and wane. This uncertainty and disruption is being felt end-to-end through supply chains.

Last, but by no means least, organisations can no longer ignore the climate change and sustainability agenda. Those that do not take immediate action face the genuine risk of extinction. As long-term stewards of capital, institutional investors are pulling out of companies that are not prioritising the environment or society and failing to make the necessary adjustments to their strategies, business models and operations.





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Sustainability regulations have already been rising and renewed policy efforts are sure to follow the UN Climate Change Conference of the Parties (COP26). Environmental, social and governance (ESG) themes have now established themselves as principal risk priorities. Businesses finally recognise that an unwillingness to accept accountability not only for their environmental and social impacts but their approaches to diversity and inclusion may cost them their futures, as customers, suppliers and workers gravitate towards genuine sustainability leaders.

Change and uncertainty will define 2022 and the years that follow. Internal audit must understand this change in the outside world, articulate how well it believes the organisation is adapting to these pressures and identify how effectively associated risks are being accounted for and managed. In many cases this will require a complete rethink of internal audit's strategy, planning and where it focuses its efforts.

The world has changed.  
Internal audit must  
change too.



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## METHODOLOGY

**In the first half of 2021 a quantitative survey was distributed amongst the CAE members of 12 Institutes of Internal Auditors in Austria, Belgium, France, Germany, Greece, Italy, Luxembourg, the Netherlands, Spain, Sweden, Switzerland and the UK & Ireland. This survey elicited 738 responses, an all-time high for this research project.**

Simultaneously, a sample of 35 Chief Audit Executives (CAEs), 12 Audit Committee Chairs (ACCs) and 3 CEOs from across these countries were interviewed to provide deeper insights into how these risks are manifesting and developing.

The following topics in this report were determined by the quantitative survey results; the qualitative feedback from the interviews has been used to contextualise the survey results, providing colour and up-to-the-minute considerations for CAEs, with priority given to new issues and emerging themes that warrant attention.

This report should not be considered prescriptive, but as a tool to inform internal audit's thinking and provide a benchmark against which CAEs can contrast and compare their own independent risk assessments.

We also hope that CAEs will use this report as an agenda item for audit committee discussions and as a sense-checking tool to support their internal audit planning and strategy.

**13**  
**European**  
**countries**  
involved

**50**  
**in-depth**  
**interviews**

**738**  
**responses**  
from CAE  
members



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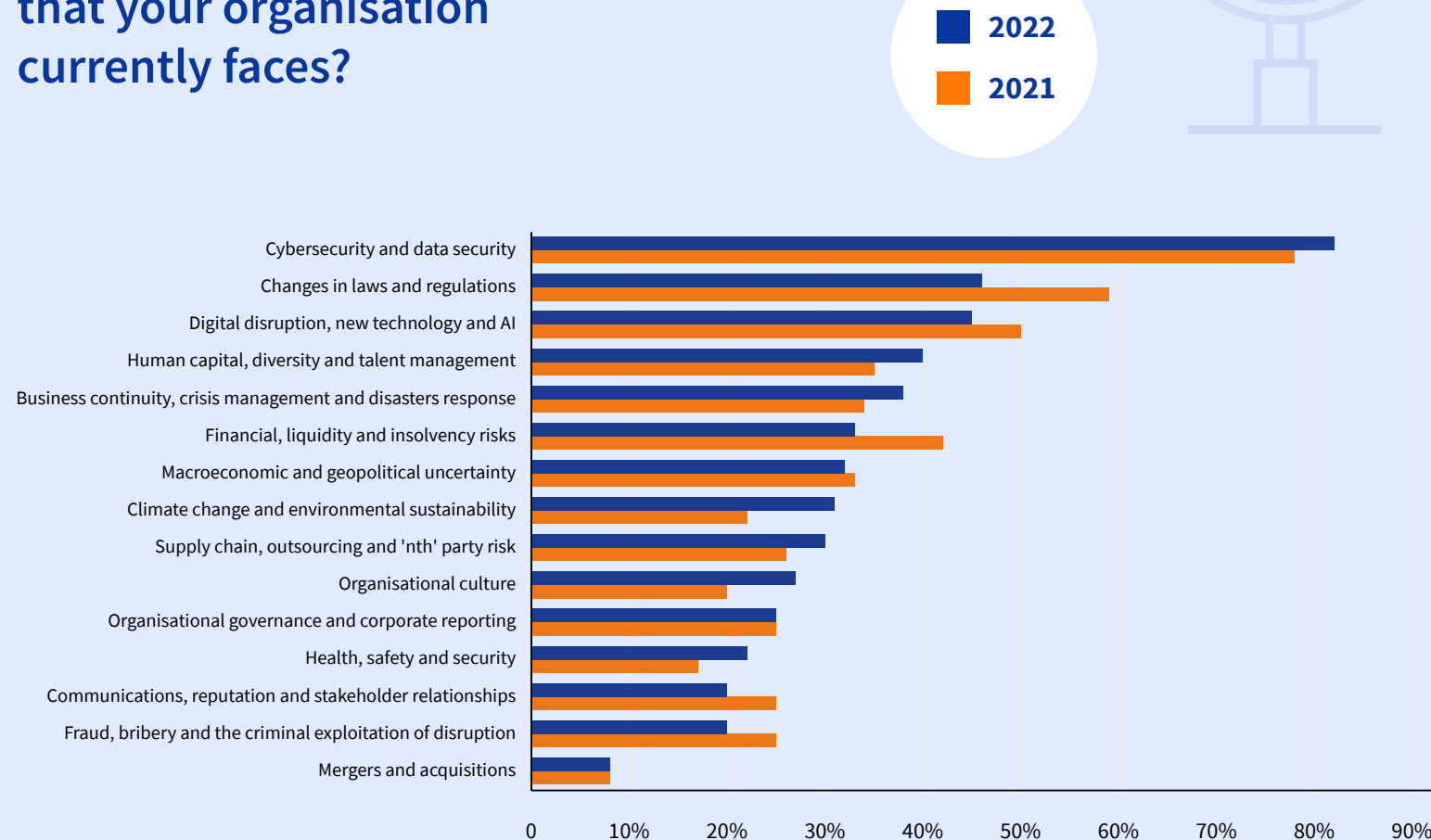
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## What are the top five risks that your organisation currently faces?



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## The risk landscape has shifted over the past year in the eyes of Europe's CAEs.

One of the more notable changes observable in the survey data is that *Financial, liquidity and insolvency risk* has become less of a priority. However, it's important to view this in context. In the second quarter of 2020, large swathes of business activity were shut down and record levels of government stimulus were infused into the economy to avert a financial crisis. Consequently, *Financial, liquidity and insolvency risk* spiked in priority in last year's report.

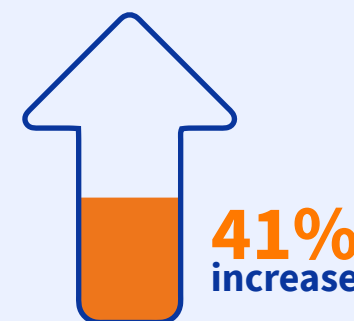
Since then, businesses have weathered a historic recession and may have newfound confidence as growth returns. But this macro recovery may be masking unforeseen financial risk. As stimulus is withdrawn over the coming months, companies should be liquidity stress testing and planning for worst case scenarios as the economy remains sensitive to further shocks and a potential wave of delayed insolvencies. Banks are now placing increasing demands on their corporate customers to understand their exposure to financial risks.

In parallel, a number of risks have come further to the fore this year, most of

which have a human dimension. *Human capital, diversity and talent management, Organisational culture, and Health, safety and security* have all gained positions in the survey ranking and more of the overall vote over the past year. This demonstrates that CAEs are concerned about the impacts the pandemic and the extended homeworking period are having on the workforce, including personnel turnover as staff reflect on their careers and reset their aspirations. The implications of a more fluid employment market are likely to be felt for some time and these challenges will have to be actively managed.

*Organisational culture* in particular has seen a 35% gain in the proportion of CAEs who view it as a top five risk, from 20% to 27%. This is supported by audit leaders in this year's qualitative interviews consistently speaking of their sense that culture is at risk of eroding—and the knock-on effects that this could have. Inevitably, against the backdrop of the ongoing pandemic, the question mark that remain over emerging variants and the return to the workplace, the health and safety of staff, customers and suppliers is also of paramount importance.

But the real story is that *Climate change and environmental sustainability* is surging up the agenda, climbing as many as four positions in the ranking and seeing a 41% gain in the proportion of CAEs who view it as a top five risk. Last year 22% of audit leaders had this among their five biggest risks; that has risen to 31%. No other risk area has shown a bigger year-on-year increase and this is a continuation of a trend: in 2020 a mere 14% of respondents put climate change among their top five risks. It's now time to act.



in the proportion of CAEs who view **Climate change and environmental sustainability** as a top five risk since last year's survey.

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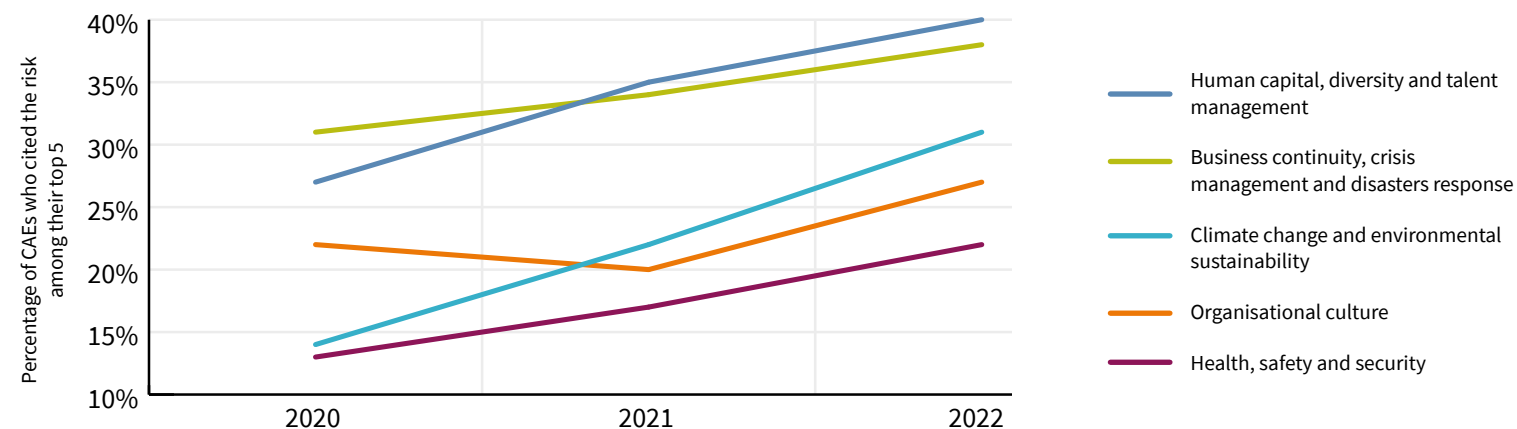
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## Risk trends over time



*Risk in Focus* is an opportunity to track how risk priorities are developing over time. A number of dominant themes are emerging. *Climate change and environmental sustainability* shows the steepest curve, gaining in prominence more than any other risk type over the past three years, according to CAEs in our sample.

The remaining four risks highlighted in the graph that are gaining in priority are highly thematic when viewed against the backdrop of the pandemic. Risks related to *Business continuity, crisis management and disasters response* have been heavily impacted by recent events, and the same is true of *Health, safety & security*, *Human capital, diversity and talent management* and *Organisational culture*. These latter three have a clear human capital element

to them. Businesses have been forced to flex and adapt over the past 18 months, protecting their workforces from harm as health risks sharply escalated. As the pandemic has rolled on for longer than many expected, companies have had to think about the psychological wellbeing of their staff and what socially distanced and remote working conditions mean for staff cohesion and culture.

It remains to be seen what the trajectory of these risks will be in future, but it is reasonable to expect that health and safety considerations will abate over the medium term as the uptake of vaccines increases. Similarly, as—or perhaps if—the pandemic comes under greater control and potentially recedes altogether then crisis management will likely fall in priority.

Human capital risks related to talent management and diversity are likely to be less transitory. Demographic pressures associated with plateauing, and in some cases declining, population growth across much of Europe combined with digital skills shortages will make recruitment and retention a persistent challenge. Meanwhile, a lack of diversity is not something that organisations can resolve overnight.

Finally, *Climate change and environmental sustainability* is a moving target that companies will have to make continuous efforts to mitigate for decades to come. This should therefore be considered a “forever risk” that is likely to move up the risk rankings over time, a view shared by the CAEs we surveyed.



# Looking ahead

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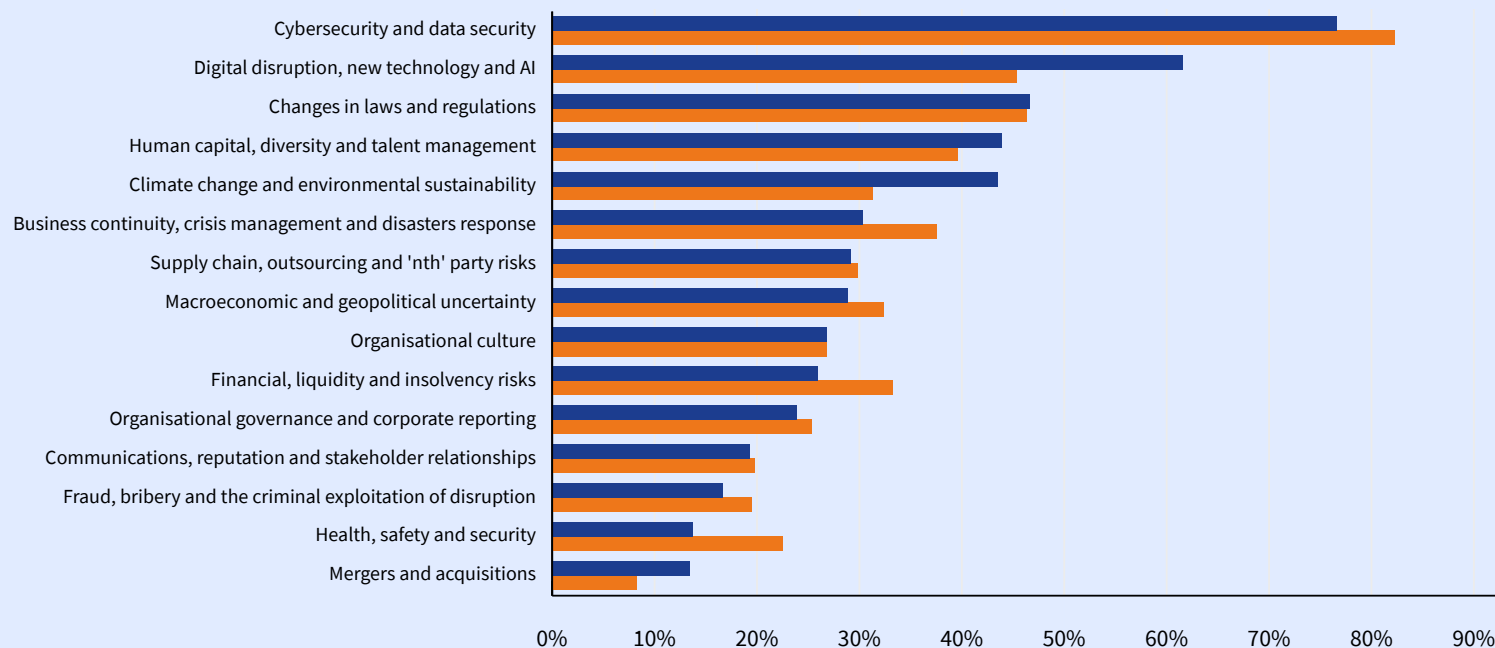
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## What are the top 5 risks that your organisation will face three years from now?



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Three years from now European CAEs believe that *Cybersecurity and data security* will become somewhat less of a risk, although this is relative. It is still expected to dominate the risk rankings and any threat mitigation will come from the fact that businesses are becoming better equipped at managing and minimising the risk of attacks and data breaches. Other risks that are expected to abate or come under greater control include *Business continuity, crisis management and disasters response, Financial, liquidity and insolvency risks*, and *Health, safety and security*. All three of these have been directly influenced by the pandemic and therefore it should be expected that they will recede in due course.

The biggest gainers over this period are expected to be *Climate change and environmental sustainability*, and *Digital disruption, new technology and AI*, both of which are becoming fundamental existential risks. The winners and losers over the coming years will be defined by their ability to adapt to the twin pressures of becoming digital-first organisations with minimal environmental impacts and best-in-class sustainability reporting and transparency. It is becoming increasingly clear that only those who prioritise sustainability in their strategies, business

models and operations—and can articulate this to investors, governments and the public—will succeed in the long term.

One fast-track method for achieving these goals is through acquisition. Rather than wholly relying on internal development and organic growth, companies can buy innovation, talent and market access via M&A. For example, the financial services sector is currently in a state of reinvention, banks acquiring fintechs to protect and grow their market share and maintain their relevance. In the consumer and retail sectors, companies are scaling down their physical footprints and leaning heavily into digital channels, a shift that is also being achieved via strategic acquisitions. Consistent with this, the survey results show that CAEs expect *Mergers and acquisitions* risk to rise over the next three years.



# Risk priorities vs. audit's focus

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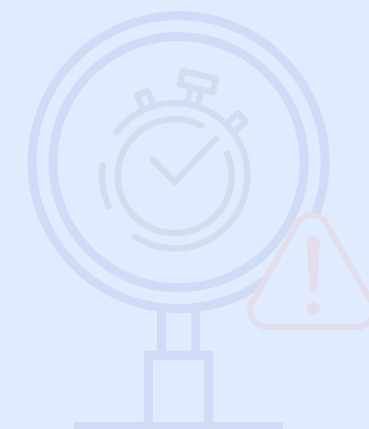
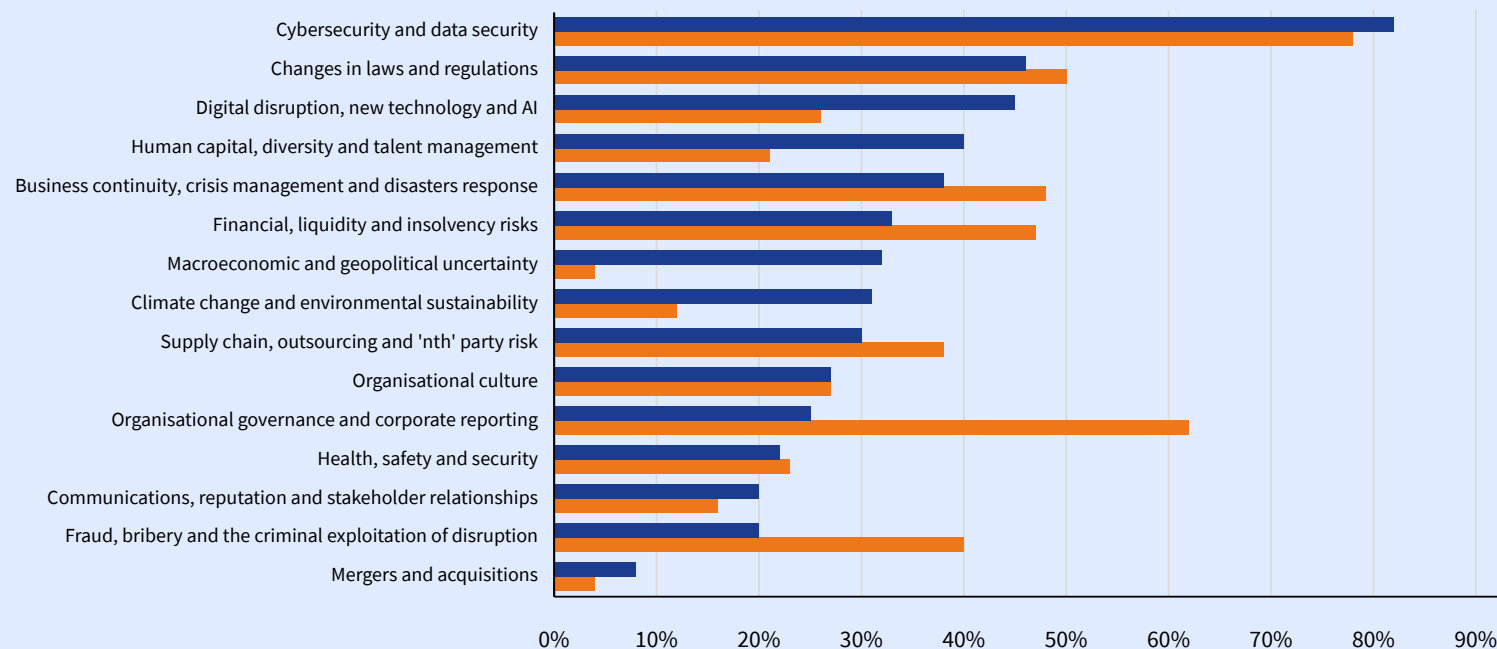
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## What are the top 5 risks on which internal audit spends the most time and effort?



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The *Risk in Focus* survey also shows how closely internal audit's time, attention and resources are being matched to what CAEs consider to be the biggest risks to their organisation. There are numerous reasons why these differentials may exist and a direct correlation between risk priority and time spent auditing should not necessarily be expected.

However, any gaps could be cause for concern, potentially indicating a lack of assurance maturity or that internal audit is not pointed in the right directions. For instance, as has been observed in previous years, *Organisational governance and*

*corporate reporting* sees much of internal audit's attention and yet is not viewed as high risk. Conversely, *Macroeconomic and geopolitical uncertainty* and *Climate change and environmental sustainability* are viewed as significant risks to the business and yet see limited attention from internal audit. This is a major problem.

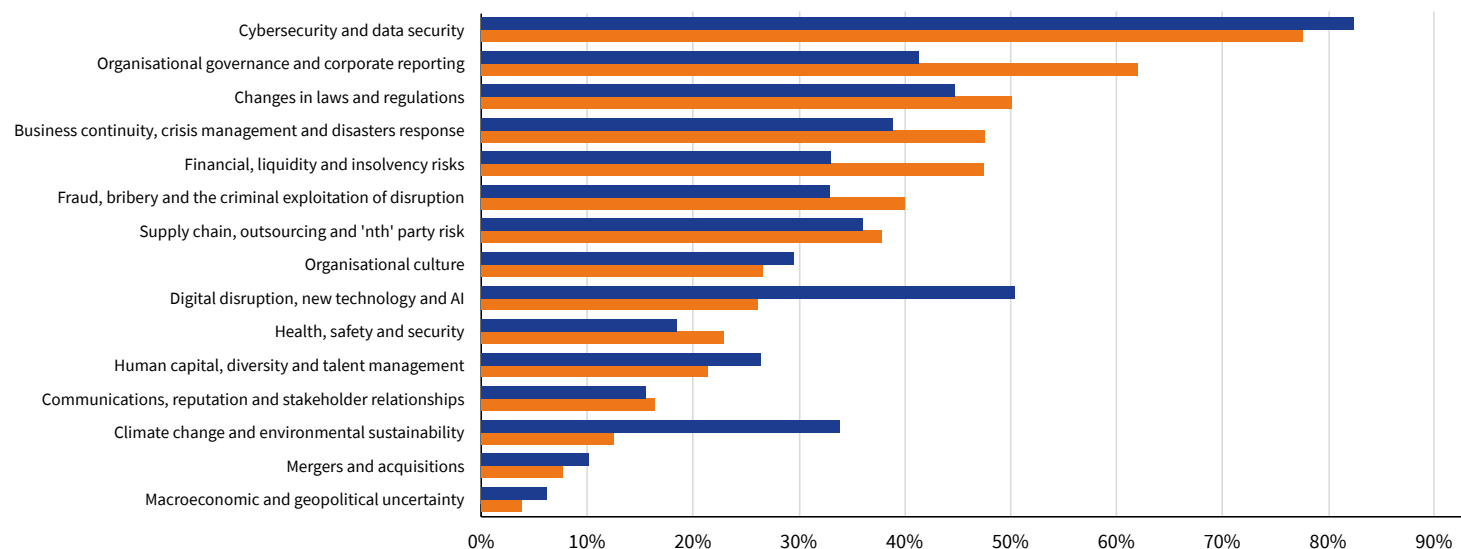
Internal audit must be bold. If audit committees expect the third line to concentrate on traditional risk areas that are already well controlled, the business is not realising the full potential of internal audit. In such cases, CAEs must push back and educate stakeholders, urging them to

harness the third line to assess big and rapidly emerging risk themes.

Looking ahead three years from now, CAEs expect internal audit's attention to be increasingly directed towards risks related to *Climate change and environmental sustainability*, and *Digital disruption, new technology and AI*. Audit leaders must push for the resources to build highly competent and highly relevant functions that can tackle these shifting assurance needs with confidence. This should be addressed urgently. Waiting until 2025 may be too late.

## What are the top 5 risks you expect internal audit to spend the most time and effort addressing 3 years from now?

■ 2025  
■ 2022





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# IT SECURITY: RESPONSE AND RECOVERY

## The research data

**82% of CAEs say that *Cybersecurity and data security* is among their top five risks, once again putting it ahead of any other risk type (#1). Not only that, 34% of CAEs say this is their single biggest risk (#1). This coincides with a material increase in cybercrime over the past 18 months, as criminals have sought to exploit the security weaknesses exposed by operational disruptions.**

CAEs in the most cyber mature organisations, particularly in the financial services sector, explain that organisations are turning their attention to response and recovery processes and procedures, and what to do in the event of ransomware events. Companies must be confident that they know how to respond when bad actors strike and can bring operations back online with minimal disruption by following established protocols.

Naturally, the best means for avoiding disruption is by preventing attacks in the first place. One of the two most common ransomware attack vectors is software vulnerabilities, with VPN (virtual private network) servers used for connecting homebound staff to centralised systems being a particular point of focus for cyber extortionists over the past 18 months. The other is emails.<sup>1</sup> This is why the human element is so important. It is estimated that 97% of phishing emails now contain some form of ransomware<sup>2</sup>, and that 95% of IT

security breaches result from human error.<sup>3</sup> Staff training and awareness is the most effective way of minimising the likelihood of workers clicking on malicious links and harmful attachments (e.g. .doc, .dot and .exe files).

However, no amount of training can totally prevent assaults from slipping through the cracks. Businesses that have yet to suffer a major incident need to recognise that it is not a question of if attackers will be successful, but when. Further along the maturity curve from protective measures (e.g. software configuration management, strong password policies and staff awareness) are response and recovery protocols. The ultimate goal is to reduce downtime and loss of revenue while maintaining customer trust. These protocols also need to be organisation-wide and not only repeatable but adaptive, so that they remain relevant and effective as the nature of the risk develops and the IT environment expands and grows more complex.

“We want to see that there is a crisis organisation established and that it meets on a regular basis and it’s trained. You want to see exercises where the whole data centre is switched off because of a breach and that the back-up works well, restarting the applications and so on. You cannot wait for the crisis to appear. People need to know what to do in the event of an emergency.”

CAE, Switzerland,  
one of the country’s  
top five banks

<sup>1</sup> Ransomware Attack Vectors Shift as New Software Vulnerability Exploits Abound  
<sup>2</sup> Phishing Statistics You Need To Know To Protect Your Organisation  
<sup>3</sup> 134 Cybersecurity Statistics and Trends for 2021



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# IT SECURITY: RESPONSE AND RECOVERY

## An internal audit perspective

Every organisation is at a different point in their information security journey, therefore internal audit must focus its assurance efforts where they are most needed. For the least mature, the third line should concentrate on the foundations: whether the business is properly risk assessing and putting in place hard and soft defensive controls. Hard controls include regularly updating software patches, properly configuring firewalls and threat detection systems, and using least privilege access and two-factor authentication (2FA) to contain attacks from spreading through the entire network from the initially compromised computer. Soft controls centre on the risk awareness throughout the organisation, sound cybersecurity culture being a key risk mitigator.

Once internal audit is confident that these foundations have been laid, its attention should turn to the business's ability to respond and recover. If IT continuity plans are not well understood by staff or, worse, there are no plans, the organisation is exposing itself to unnecessary risk. The third line should therefore seek evidence that these scenarios are being planned for, including dry run exercises, and that there are dedicated cyber crisis management and recovery resources in the business with clear lines of accountability and timely incident reporting.

“You do not know what is happening at the beginning of the ransomware attack, the decision-making is difficult, there is time pressure. I’m trying to see if we are ready or not to take the right decisions.”

CAE, France,  
CAC 40 manufacturer



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# IT SECURITY: RESPONSE AND RECOVERY

## An internal audit perspective

### Questions for internal audit

- Does the organisation have a cybersecurity strategy or roadmap? How far has the organisation progressed in achieving this?
- Is there a staff awareness and training programme in place to prevent successful attacks? Are these regularly updated?
- Is a cybersecurity response and recovery plan in place and is it tested?
- Does the organisation make data backups that it can use in the event of an attack? How does the organisation know that the backups are secure?
- What is the organisation's ransomware policy (does it pay up or not?) and are people aware of it?
- Do insurance policies appropriately cover IT security risks? Is incident reporting likely to be fast enough to meet the coverage requirements of insurers for successful claims?
- Is the organisation confident that it won't suffer an attack via its vendors or clients? Why is it confident, e.g. are third parties ISO 27001 certified?
- Does any penetration testing include all areas of the business, including potentially overlooked subsidiaries in non-core markets?

### DID YOU KNOW?

The volume of ransomware attacks increased by 150% in 2020<sup>4</sup>, more than any other kind, as criminals have sought to exploit the migration to remote working for financial gain. Victims also paid 311% more in ransom to have their data and systems decrypted by perpetrators over the same period.<sup>5</sup>

It is estimated that among recent ransomware victims, 56% recovered their data via system backups and 26% paid the required ransom to have their data returned.<sup>6</sup> This underscores the importance of response and recovery measures. Even paying criminals is a form of response and a route to recovery and if this is agreed policy, it must be documented and understood by the IT security function the CISO, the rest of senior management and the board.



4 Ransomware Attacks Soared 150% in 2020  
5 Key Recommendations from the Ransomware Task Force  
6 The state of ransomware 2020

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# RISING SUSTAINABILITY REGULATIONS

## The research data



**The regulatory burden is a perennial risk that stays firmly at the top of business's risk registers, especially for banks and others operating in regulated markets. *Changes in laws and regulations* is among the top five risks for 46% of CAEs this year (#2, maintaining its position from a year prior but with a significantly smaller share of the vote), though only 8% have it as their number one risk (#5). Regardless of their sector, companies should be paying close attention to rising sustainability requirements.**

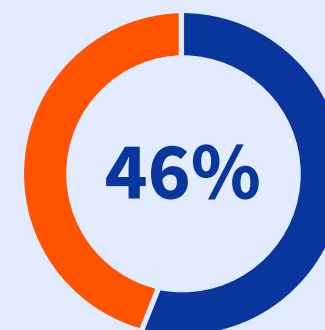
In November the UK will host the COP26 UN climate summit, world leaders convening to discuss how actions can be accelerated towards the goals of the Paris Agreement and the UN Framework Convention on Climate Change. Inevitably this will mean more policymaking and increased regulations. However, the regulatory train is already in motion. Global ESG regulations and laws have grown by 90% since 2016<sup>7</sup> and policymakers continue to step up their efforts. CAEs, ACCS and CEOs in our research almost universally spoke of the increasing regulations their organisations face, with attention quickly turning to sustainability reporting.

In April 2021, the EU adopted a package of measures as part of its mission to slash greenhouse emissions by at least

55% by 2030, and reach carbon neutrality by 2050. The package includes the final EU Taxonomy Climate Delegated Act, applicable from 1 January 2022. The act is the first set of technical criteria defining activities that contribute substantially to climate change mitigation and adaptation, essentially supplementing the broad brush framework of the EU's Taxonomy Regulation, which entered into force on 12 July 2020. A second delegated act is due to follow in 2022.

The broader package also included a proposed Corporate Sustainability Reporting Directive (CSRD), intended to replace the existing Non-Financial Reporting Directive (NFRD), which is widely seen as having fallen short of the mark. The CSRD aims to make sustainability reporting more consistent, so that investors

**Changes in laws and regulations** is among the top five risks for 46% of CAEs.



Although only 8% of CAEs see it as their number one risk.

and the public can use comparable and reliable information. Crucially, the proposal significantly enlarges the scope of the current reporting requirements



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# RISING SUSTAINABILITY REGULATIONS

from the 11,000 companies that are currently subject to the NFRD to some 50,000 companies.<sup>8</sup> This nearly five-fold increase in scope is because the rules are expected to apply not only to every single company with tradeable instruments on Europe's stock and bond markets, but all large companies whether they are listed or not. Unlike the Sustainability Finance Disclosure Regulation, which came into effect in March 2021, these reporting requirements are intended to apply across sectors, not just in the investment industry.

While Britain has left the EU, UK businesses cannot ignore the rising tide of sustainability regulations. As part of its 2020 Roadmap and Interim Report, the government intends the UK to become the first G20 country to make reporting aligned with the Task Force on Climate-Related Financial Disclosures (TCFD) mandatory across the economy, so this is not solely a concern for EU businesses.

“The main thing is around who we lend to. Do we lend on clean energy? How do we make sure that it's really green? How do we aggregate the reporting? How do we stress test for climate risk? There's a lot of movement in that space with the new taxonomy.”

CAE, Luxembourg,  
development finance bank



<sup>8</sup> Sustainable Finance and EU Taxonomy: Commission takes further steps to channel money towards sustainable activities

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# RISING SUSTAINABILITY REGULATIONS

## An internal audit perspective

Third lines in banking and insurance companies are now long familiar with the rising tide of regulation, so, while challenging, these emerging rules are the continuation of a theme. For others, recent cross-sector efforts to deliver assurance around GDPR should stand internal audit in good stead for stricter compliance obligations.

The introduction of the EU Taxonomy Climate Delegated Act and the forthcoming CSRD provide greater clarity on what is expected of EU companies in their sustainability reporting. The same is true for UK businesses with the intention of the UK government to make TCFD-aligned sustainably obligatory. These developments give the third line concrete criteria to audit against.

While internal audit is not usually directly responsible for compliance, for smaller, less mature organisations it may choose to raise flags, highlighting which forthcoming regulations may need to be met. For instance, given that the CSRD will capture far more EU companies within its scope, the third line can bring to the board and senior management's attention that the first set of standards are expected in October 2022, with a second set to follow in 2023. For more mature organisations, internal audit will need to assess the compliance function's work, checking the efficacy of any processes and controls that have been modified to deliver on these emerging requirements.

### Questions for internal audit

- Is internal audit providing assurance over the translation of relevant sustainability regulations into organisational commitments, policies and plans? Are the plans adequate and are they being delivered?
- Is the organisation aware of its sustainability reporting requirements and is it taking action to address this? Is internal audit or some independent party providing assurance over this reporting?
- Do the data and statements disclosed in non-financial reporting accurately reflect the activities of the company? Could it be reasonably concluded that the company is greenwashing or is it doing what it claims?
- How well developed is the governance around sustainability reporting? For example, are roles and responsibilities clearly defined?
- Does the company have a system of prioritising regulations, whether related to sustainability or otherwise, and does it take an appropriately risk-based approach to managing compliance?





# ACCELERATED DIGITALISATION AND LOW-CODE ADOPTION

## The research data

**Digital disruption, new technology and AI remains a priority, with 45% of CAEs citing it among their top five risks (#3, maintaining its position from a year prior) and 8% putting it as their top risk (#4).**

The pandemic and its restrictions on physical contact brought the necessity for digital transformation into sharp focus. Digital laggards were left especially prone as countries went into lockdown, while those that had already executed on their digital strategies were at a distinct advantage. Any businesses that did not previously recognise the need to digitalise their operations and business models certainly do now.

Virtually all CAEs, ACCs and CEOs we interviewed flagged the risks and opportunities associated with digitalisation and the pace of this change as a priority area of attention. Aiding this digital acceleration is the use of low-code development platforms. By enabling developers to create software apps using graphical interfaces instead of hand coding them, low-code has expedited digitalisation during the pandemic,

allowing businesses to roll out mission-critical solutions and expand digital channels at speed when they were most needed. It has been estimated that 64% of UK software developers increased their use of low-code tools in 2020 in response to the global lockdown.<sup>9</sup>

Businesses are expected to increasingly rely on low-code software development using tools such as Microsoft's Power Platform, Salesforce and Mendix<sup>10</sup> to help accelerate their progress. It is estimated that by 2024, 75% of large enterprises will be using at least four low-code development tools.<sup>11</sup> Meanwhile, the global low-code market is expected to grow by 22% in 2021, to \$13.8bn.<sup>12</sup>

While much of this will be reserved for use by IT functions, the rise of so-called citizen development initiatives shows the opportunity, and the risk, that lies ahead.

Citizen development helps to address the shortage of technically skilled workers by empowering non-technical employees to build apps that solve immediate problems. This can help overstretched IT functions unable to keep up with the many demands of the business. The benefits of this should not be understated.

That is the opportunity. The risk is that by lowering the bar for who can develop apps, effectively democratising digitalisation, the organisation may be increasing its blind spots. Companies may no longer have a true picture of the extent of digitalisation within their organisation, who is responsible for it and where the risks lie. In an effort to drive swift change, digitalisation may proliferate unchecked and key controls may not be paid their due attention, increasing security and data privacy vulnerabilities.

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<sup>9</sup> The 'low-code' imperative

<sup>10</sup> Magic Quadrant for Enterprise Low-Code Application Platforms

<sup>11</sup> Gartner 2020 Magic Quadrant for Enterprise Low Code Application Platforms

<sup>12</sup> Surge in Remote Development Boosted Low-Code Adoption Despite Ongoing Cost Optimization Efforts

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# ACCELERATED DIGITALISATION AND LOW-CODE ADOPTION

## An internal audit perspective

With digitalisation shifting up a gear, the third line's first concern should be whether the business model is being sufficiently adapted to meet the new digital reality. Any evidence identified by internal audit of competitors innovating in ways that could threaten the business should be brought to management's attention so that it can take urgent strategic action.

Turning to the development that is already underway, the third line can assess whether core risk management principles are being embedded into projects. Of particular concern is the widespread uptake of low-code tools. The greater the adoption of these tools among non-IT personnel, the higher the risk.

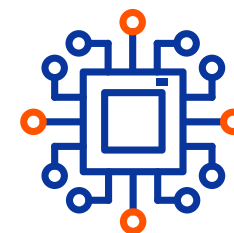
While this may appear to be uncharted territory, low-code and no-code development is a continuation of a theme that internal audit should already be familiar with. End-user development has

been deployed for years already, such as the use of pivot tables and macros in Microsoft Excel to create invoice management systems or Microsoft Access to run database queries.

Internal audit should therefore return to the basics and assess whether any low-code app development and usage follows the company's established standards and protocols, including reviews, testing and staged deployment. IT functions will need to ensure they know exactly what low-code projects are in development and apply appropriate permissions controls so that critical data is not lost or misappropriated. What is more, it may be impossible to know exactly what is happening under the bonnet of these platforms and whether they are inadvertently introducing security flaws to the organisation. Given that the majority of low-code platforms have third-party integrations, it is possible that, even if the platform supplier releases security

patches, critical updates are not rolled out in a timely manner, particularly if the organisation loses track of its low-code components.

Internal audit may choose to independently map all digital projects throughout the business and check that this matches the IT function's own mapping of current activities. In the broadest sense, the third line should check that digital projects, big and small, uphold the same standards expected of more traditional projects directly managed by the IT function, and confirm that there is appropriate oversight from the information security team.





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# ACCELERATED DIGITALISATION AND LOW-CODE ADOPTION

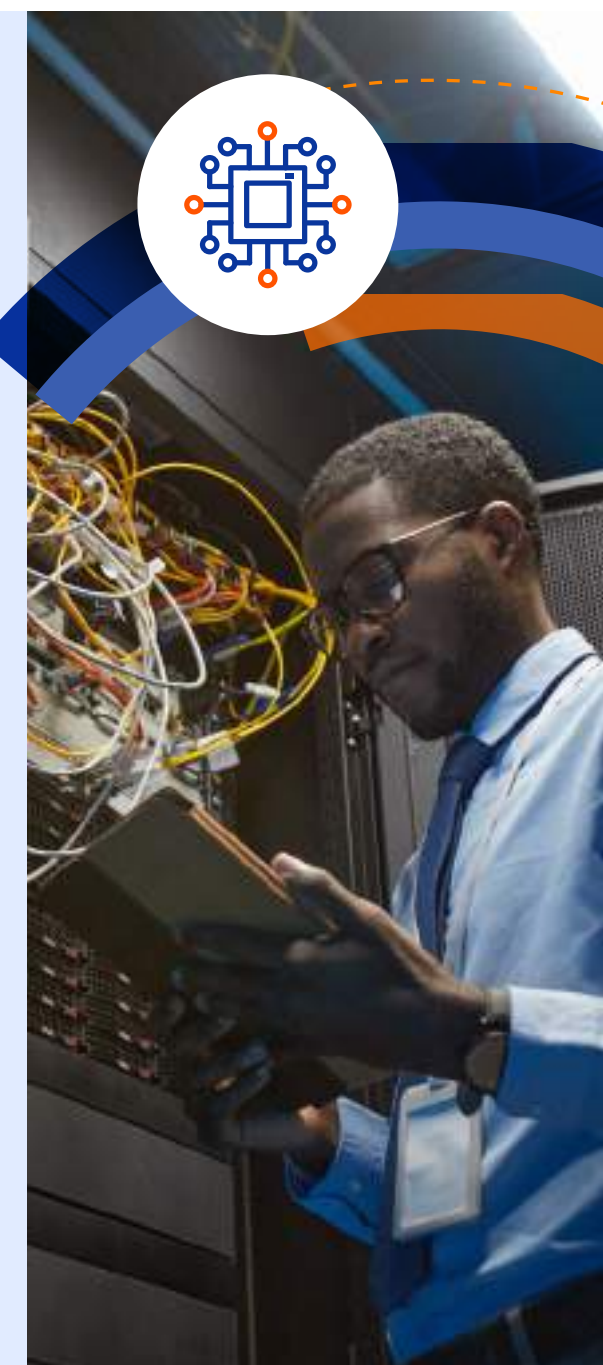
## An internal audit perspective

### Questions for internal audit

- Is the IT function fully aware of all digitalisation projects and sub-projects underway across the organisation?
- Is the organisation allowing citizen/end-user development? If so, are access rights and version roll-outs managed to avoid unintentional errors?
- Does current digitalisation activity match the organisation's risk appetite? From a back-to-basics perspective, does this digitalisation meet the established standards adopted by the organisation? Are the standards themselves fit for purpose?
- How much oversight do digitalisation projects have from the IT and IT security functions?
- Are agile methods delivering practical results at the expense of risk management? For example, are new applications being sufficiently security tested?
- Is there a programme in place for automatically patching any low-code apps that are in use?

“The risk I see is the IT infrastructure itself. We do a lot of internal development today because we don't want to be too dependent on a vendor. We have an innovation team that is not part of IT, it's in a grey zone. You have risks that are created because of developments not being sufficiently tested, documented or formalised because the business wants to use agile methods.”

CAE, France, private bank



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# WORKFORCE FATIGUE AND CULTURAL EROSION

## The research data

**Human capital, diversity and talent management** is cited by 40% of CAEs as being among their top five risks (#4, up one place from last year), up from 35% in 2021 and 27% in 2020, a clear uptrend. Meanwhile, 27% view **Organisational culture** as a top five risk (#10, up one place from last year), a notable year-on-year increase of seven percentage points. As businesses weigh up what working models to embed post-pandemic, the risks to culture, morale and staff cohesion should not be underestimated.

The atomisation of organisations in the homeworking environment has delivered some unexpected benefits. In Europe, 82% of senior executives have reported that productivity levels either held steady or increased as people migrated to remote work and, over half believe that some degree of remote working is here to stay and that it will play a powerful role in retaining top talent.<sup>13</sup>

However, it's not all upside. Recent research has shown that 47% of UK employees are less career focused because of the pandemic and 40% are concerned about work-related burnout<sup>14</sup>, suggesting an extended period of staff churn could be ahead. Separately, it has been found that globally as much as 46% of workers are considering leaving their employer because they are now able to work remotely.<sup>15</sup>

Businesses may also be overlooking risks that are less simple to measure. Interviews with CAEs for this year's *Risk in Focus* elicited opinions not only on talent management and skills shortages, but the impact that remote working and hybrid models might be having on culture, irrespective of any productivity benefits.

The lack of social interaction between colleagues may be eroding team cohesion and culture. Staff may be losing their sense of belonging or becoming fatigued and disengaged with their work. As effective as online collaboration tools and videoconferencing software have been in keeping the wheels turning and people connected virtually, there is no substitute for in-person interaction and small talk for fostering creativity, problem-solving and keeping the organisation's culture alive.

All of this could have negative downstream consequences. Culture and closer co-working is inextricably linked to factors as diverse as innovation and conduct. Without open sharing of ideas, the business may not be able to as effectively develop products or new ways of better serving customers.

If people feel less connected to their teammates and are unable to clearly see how their work contributes to the greater good of the company and its purpose, they could begin to stray. Disengagement has the potential to increase fraud and other misconduct as workers lose their sense of loyalty and put their own interests before the interests of their colleagues and the company. This may be compounded by limited oversight from management, which can result in the weakening of the soft controls environment and poorer internal communications and reporting, increasing the likelihood of undesirable behaviour.



<sup>13</sup> Flexible ways of working are here to stay, finds new European research – with leaders focused on maintaining culture and innovation

<sup>14</sup> Building resilience for the new realities of work  
<sup>15</sup> Microsoft Work Trend Index

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# WORKFORCE FATIGUE AND CULTURAL EROSION

## An internal audit perspective

It may be too early for internal audit to conduct formal assessments of how effectively behavioural and cultural risk is being managed, given the fluidity of the present situation. However, the third line can get a “feel” for any weakening of staff morale and motivation and the overall cultural health of the company. This can be achieved by engaging with people on the ground and flagging any concerns with the board or audit committee.

If companies aim to permanently move towards hybrid working models, they will need to understand what impact this is having on productivity, innovation and the risk and control environment. Once the strategy has been formalised and embedded, internal audit can begin to think about how to address this. One approach would be directly auditing the culture; another would be to assess what HR and the second line are doing to understand and address any cultural erosion that’s occurring, such as conducting staff surveys and employing behavioural science techniques to determine whether workplace incivility and disengagement is becoming a growing threat to the organisation’s success. Steps will then need to be taken to remedy this and re-establish a sound and healthy culture.

### Questions for internal audit

- What sense is there that the culture has eroded and integrity has weakened, and is there an awareness of this within HR, middle management and senior management?
- Are efforts being made to promote the organisation’s core values and mission?
- What steps is the organisation taking to check in with staff? Is middle management sufficiently attentive to business teams? Is there anything quantifiable to support this?
- Is reduced in-person interaction having a detrimental impact on either productivity (less likely) or innovation (more likely)? How is this manifesting and being measured?
- Is staff turnover increasing? How long does it take to fill vacant positions? Is talent management to continuously attract and retain employees working?



“What hasn’t necessarily been dissected enough is what the impact of new working models will be. There is a big risk that it’s eroding culture. How do you keep the culture alive when everything’s remote or hybrid and when you’re not interacting in-person?”

CAE, Ireland, travel operator listed on Euronext Dublin

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# PANDEMIC RESPONSE: ORGANISATIONAL AND STRATEGIC RESILIENCE



## The research data

**38% of CAEs consider *Business continuity, crisis management and disasters response* to be a top five risk (#5), a small gain on last year (34%). Companies that have succeeded during the crisis period have not only met the short-term challenge of maintaining continuity, but have responded to the unexpected shocks of the pandemic by developing resilience and refining their strategies.**

The events of 2020 caught even the most prepared businesses off guard. Unlike the physical events that businesses commonly plan for (extreme weather, power outages, cyber-attacks etc), the pandemic has been pervasive, simultaneously impacting employees, suppliers and customers across the globe and for a duration previously not considered a possibility. It goes without saying that organisations should be updating their business continuity plans (BCPs). This will require careful examination of how effective crisis responses have been and BCPs should now include a pandemic scenario, incorporating lessons learned to better respond to similar future crises. These will need to include staff safety, supply chain and cyber risk mitigation measures. Greater resilience can be achieved by covering these basics, putting the organisation on a stronger footing should another pandemic or other crisis event occur.

## From surviving to thriving

However, recent lessons have had far deeper, lasting implications. It is said that in every crisis lies opportunity and the pandemic has been a catalyst for what in many cases has been positive change. As part of their crisis response, businesses are addressing strategic risks that have been lingering for years.

Analysis has shown that around half of senior executives in Europe report that the crisis exposed weaknesses in their companies' 'strategic resilience', i.e. the extent to which an organisation's business model and competitive position prove resistant to disruption. What is more, business-model innovation was by far the most important differentiator in addressing the crisis.<sup>16</sup>

Companies have had to strike a balance between coping with recent immediate disruptions and planning to thrive against the backdrop of reshaped demand and changing consumption patterns as economies reopen. Those who have failed to adapt to the change in circumstances by making necessary course corrections could be exposing themselves to longer-term existential risks as their business models quickly lose relevance.

The flip side to this is that strategic and operational adjustments and adaptations carry not only potential rewards but their own risks too. In the pursuit of securing the future of the business, any rapid and fundamental changes made during the pandemic period may create a domino effect, informing future strategic decisions and changes to the business.

<sup>16</sup> Strategic resilience during the COVID-19 crisis



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# PANDEMIC RESPONSE: ORGANISATIONAL AND STRATEGIC RESILIENCE

## An internal audit perspective

CAEs should already have a sense of how well their organisations coped with the crisis and whether any shortcomings are well understood by the first and second lines. The third line can assess whether lessons are being incorporated into updated BCPs, which should now include future pandemics as possible future scenarios. The ability to anticipate and plan for future crises is how organisational resilience is achieved.

Any sweeping operational pandemic responses, such as cost-cutting or cost-conserving programmes, should be followed up by the first line to determine whether they are delivering positive outcomes or need to be reassessed. Internal audit may support this activity with reviews of its own, independently providing evidence of how effective these changes have been.

It is ultimately for the CEO and the rest of senior management to define and set the strategy and it is not for internal

audit to opine on any pivots or changes of course. But the third line should keep its nose to the ground to identify any meaningful changes that could have risk implications, develop a view on whether they are working as expected and flag any concerns with the board and management. This can involve gauging the level of staff awareness regarding these changes and whether the strategy is taking root. From an upside perspective, internal audit may be able to identify opportunities for further change, such as efficiency improvements or operational restructuring.

The main point is whether the business has the awareness, processes and accountability in place to monitor whether any big changes are delivering their expected benefits. If there is no follow-up in the first line then the organisation could be setting itself in a direction without a clear view of where it is heading or whether it needs to rethink its business model or strategy to more effectively compete in the changing business environment.

“I will be looking at how the business has bridged any gaps identified in protecting people. I will also look at incident response and how we responded through our BCP, including whether VPN connections for such a wide range of people working remotely is included in our plans for other scenarios.”

CAE, Greece, insurer listed on  
Athens Stock Exchange



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# PANDEMIC RESPONSE: ORGANISATIONAL AND STRATEGIC RESILIENCE

## An internal audit perspective

### Questions for internal audit

- Has the organisation updated its BCP, incorporating any lessons learned from the recent pandemic response and taking into account future crises as possible scenarios?
- What are the lasting impacts of the pandemic on the organisation likely to be and are these well understood by the leadership?
- Is the organisation capable of strategically adapting to gain competitive advantage?
- What strategic pivots and operational adaptations have been made and are these required for the long term or are they short-term measures?
- Have any major changes to the business model affected the risk-control environment and who is addressing this?
- Are the impacts of any big decisions being monitored and followed up on? For example, does senior management have a clear understanding of whether any changes to the strategy are delivering the expected benefits?
- Were any big decisions based on accurate data and sound information? Has the data and the business context shifted since then, potentially requiring the business to pivot back or in a new direction again?



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# FINANCIAL RISK AND THE LOOMING INSOLVENCY WAVE

## The research data

**33% of European CAEs view *Financial, liquidity and insolvency risk* as among their top five risks (#6, down two places), a significant fall on the 42% who said the same a year ago. However, 10% of the sample consider this to be the single biggest risk to their organisation, ahead of every other risk type other than *Cybersecurity and data security*.**

Unprecedented government stimulus has been a godsend for employers and employees. Furlough schemes and state-backed bank loans minimised unemployment and provided companies with the working capital necessary to continue their operations. The effects of these emergency measures have been overwhelmingly positive: administrations in the UK, for example, fell to historic lows during the first year of the pandemic.<sup>17</sup>

Unfortunately this financial support cannot last forever. With Europe having coped with successive waves of infections, with the potential for more to follow, financial risk within a number of sectors remains at elevated levels. Services, leisure, hospitality and travel sectors are at the mercy of government policy and, approaching two years into the pandemic, the future of businesses in these industries is still in question.

It has been estimated that global insolvency rates will increase by 13% in 2021 compared with 2019 and by as much as 27% in 2022.<sup>18</sup> This activity will be concentrated in high-risk sectors which have been through an extended hibernation period with cash flows slowing to a trickle. Once policy support is eventually exhausted, it will inevitably have knock-on effects for the banking sector. If loan defaults rise materially then lenders will have to contend with high credit risk and weaker profitability.

This contagion can also spread through value chains. Companies may have exercised leniency towards customers for as long as possible. With the pandemic having worn on for an extended period, there will be less incentive to offer trade credit and payment deferrals. This could lead to the insolvency of key suppliers and clients, exposing businesses to the

financial risks of partner firms' weakened balance sheets.

This should compel businesses to monitor their cash flow management, assess the creditworthiness of critical business partners, invest in payment monitoring and recovery capabilities, identify customers that may be at risk of failing to make good on their payments, reduce liabilities and ensure that any credit insurance policies are up to date. To understand their financial strength, businesses should also be frequently stress testing and planning for worst-case scenarios.



<sup>17</sup> Administrations fall to historic lows

<sup>18</sup> Covid-19: how to protect yourself against rising insolvency risk

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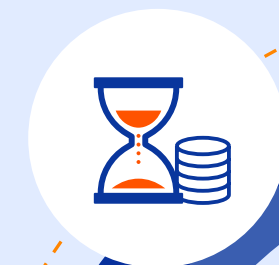
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# FINANCIAL RISK AND THE LOOMING INSOLVENCY WAVE

## An internal audit perspective



Last year's *Risk in Focus* showed that CAEs were firmly concentrating on the financial resilience and liquidity of their organisations, by checking that the business was doing everything in its powers to secure payments owed and minimise outgoings.

Having faced off these short-term liquidity constraints, the business may be confident that the worst is over. But financial risks remain high. Boards and audit committees may seek independent assurance that cash flow management remains a priority and is under control, and that efforts are being made to monitor the situation outside of the business itself. This may require a confirmation from internal audit that the business is using all available internal and external data to assess the situation as it evolves.

If insolvencies rise in correlation with the withdrawal of government support, businesses could find that customers are no longer able to pay. The third

line should therefore confirm that monitoring of high-value business partners is in place to minimise the likelihood of any unexpected shocks and that the business's insurance sufficiently covers any credit risk. This may also require an independent assurance that the business is acting appropriately and within the bounds of its contractual obligations, either in negotiating its own costs or chasing up payments.

For businesses that are cash poor, internal audit's attention may be directed at the treasury or finance function to determine the strength of decision-making processes and that financing or refinancing facilities have been put in place to optimise the capital structure and see the business through. As the earnings distortion caused by the pandemic normalises, the third line can assess whether cash flow forecasting is proving to be accurate again so that the business fully understands its liquidity risk exposure as growth returns.

### Questions for internal audit

- What is the business's liquidity risk exposure? Does it have enough cash on its balance sheet to withstand any continued lack of demand and is there an up-to-date and effective cash management strategy?
- Are key business partners still being monitored and is credit insurance in place to cover the potential failure of customers?
- Does the treasury or finance function have clear visibility on what the cash needs of the business will be and a firm grip on cash management?
- Is the company making the most of borrower-friendly financing conditions, e.g. by refinancing existing debts that may fall due soon or securing lower rates? Is a borrowing strategy in place?
- Does the business have access to working capital to be able to scale operations back up as growth returns?

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# RISING INFLATION AND THE GLOBAL TAX CLAMPDOWN

## The research data

**32% of CAEs say that *Macroeconomic and geopolitical uncertainty* broadly defined is among their top five risks (#7, maintaining last year's position), while 10% say it is their top risk (#3). Inflation has spiked with the economic restart and the governments of the world's leading economies are training their crosshairs on global corporation tax rates.**

Economies roared back to life in 2021 following the deepest global recession since the second world war. This is undeniably positive news. However, the sharp return of demand is causing prices to soar, in some cases at rates not seen for over a decade. Annual consumer price growth across the eurozone reached 1.9% in the year through June 2021, nearly triple the rate a year prior. In the US, the effect has been even more acute, inflation increasing by as much as 5.4% over the same period. Around one-third of interviewees including CAEs, ACCs and CEOs expressed concerns over macroeconomic uncertainty despite the ongoing recovery, with some singling out rising prices as an area to watch.

Central banks have sought to allay fears that they will adjust their ultra low-rate policy in the near term to curb rising

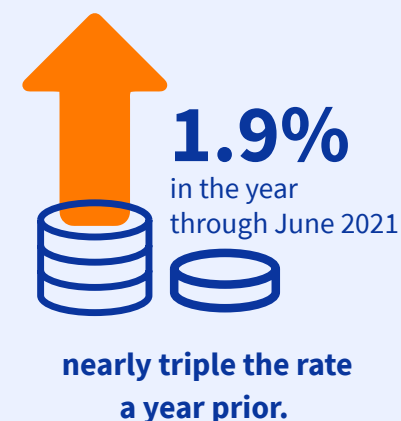
prices. They hold that this is a temporary phenomenon caused by the whiplash effect of the pandemic, as the demand for goods and services imploded before resurging in 2021. By this logic, recent inflation will be transitory, normalising as the pandemic abates.

Not everyone agrees. Stimulus has reached epic proportions and the longer-term view is that by printing money at a rate never seen before, currencies will devalue while fiscal stimulus will create demand beyond economies' production potential, risking an episode of persistent inflation not seen since the 1970s.<sup>19</sup>

To the extent that businesses are unable to pass these costs along, earnings margins will come under pressure. As goods rise in price with the consumer-led rebound, employees are likely to seek higher wages to meet their own increasing living costs.

Companies will therefore need to keep a close eye on their cost of production and revenue management to determine whether recent developments are merely a blip, or spell a more fundamental and lasting macroeconomic pressure.

Annual consumer price growth  
across the eurozone reached



<sup>19</sup> Deutsche Bank warns of global 'time-bomb' coming due to rising inflation



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# RISING INFLATION AND THE GLOBAL TAX CLAMPDOWN

## G7 tax efforts

At the same time that companies are facing the prospect of absorbing higher costs, the world's most wealthy nations are coordinating to introduce a new global corporation tax. The aim is to tax multinationals in each country in which they operate, preventing them from profit shifting to low-tax havens.

Two key proposals are on the table: allowing governments to impose levies on 20% of the profits companies make in their country if their margins are greater than 10%; and a tax at 15% of profits in each country where the company operates, regardless of their earnings margins. It is difficult to know exactly how much more tax companies would pay if this global clampdown goes ahead since companies do not uniformly report their accounts on a country-by-country basis. The proposals may also take months if not

years to formalise and embed. However, what is clear is that governments are highly indebted as a consequence of the pandemic and are under renewed pressure to close public deficits and reduce sovereign debts. A new global tax would be a further dent to profits at the same time that inflation has the potential to increase overheads and squeeze margins.

“The post-pandemic impact is probably the most important unknown. I expect default risk to go up. Inflation risk is going up and that will affect businesses.”

CAE, Switzerland,  
insurer and constituent  
of the Swiss Market Index



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# RISING INFLATION AND THE GLOBAL TAX CLAMPDOWN

## An internal audit perspective

Inflation risk depends on the company in question. Companies with strong intellectual property are better able to raise their prices to cover the costs of everything from raw materials to labour. Those with weak value propositions will be more exposed and may have to absorb higher costs. Another consideration is what will happen to interest rates. If inflation persists as the pandemic recedes, central banks may be forced to tighten monetary policy. This means that, having borrowed through the pandemic to raise cash and improve liquidity, businesses carrying large debts could struggle.

If in its independent risk assessment the third line deems the business to be exposed, it can assess how well understood this inflation risk is and what the business is doing to combat it. For instance, procurement functions may seek competitive sources of supplies and in locations closer to the site of production, thereby reducing freight costs. Revenue managers may have to make product pricing adjustment decisions, analysing

company data and benchmarking it against the competition. Treasury functions may be expected to lock in currently low financing rates while they are still available, refinancing any floating-rate loans with fixed-rate bonds. Since internal audit has a holistic, company-wide view it is uniquely positioned to determine whether disparate functions are taking appropriate measures and are effectively coordinating.

Global tax risk, meanwhile, is longer term in nature. Companies will not be able to respond until wealthy nations decide on the next steps to take and governments take coordinated actions to prevent profit shifting. Boards and senior management will already be discussing this looming threat and so CAEs should monitor the situation, raising the topic in relevant committees and meetings if it is being overlooked. A formal audit programme can be developed once it is understood what changes the company will need to make to be tax compliant.



### Questions for internal audit

- Is the business in an industry that is especially exposed to inflation, e.g. consumer goods, food retail, transport?
- Is senior management having discussions about the potential for long-term inflation and what it means for the business? If not, does internal audit need to flag this as a potential area of concern that requires attention?
- To what extent are procurement functions factoring rising costs into their buying decisions? What actions are being taken?
- Are treasury functions taking full advantage of borrower-friendly financing conditions to secure low borrowing rates?
- Is the revenue management function assessing any price increases that need to be made in order to maintain and grow profitability without putting turnover at risk?
- How sensitive will the company be to proposed global corporation tax changes? Is this being planned for?

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# CLIMATE CHANGE AND SUSTAINABILITY IS NOW A PRINCIPAL RISK



## The research data

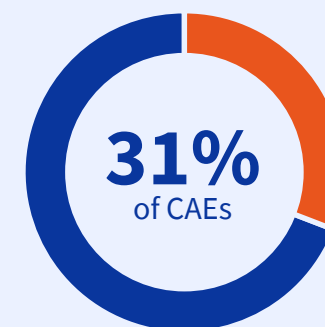
*Climate change and environmental sustainability is seen as a top five risk by as many as 31% of CAEs (#8, up by as many as five places from last year's survey), representing an increase of more than 40% on last year's survey when 22% of CAEs said the same. In the space of two years this topic has gone from a talking point to a principal item on risk maps and corporate risk registers.*

Slashing emissions, adopting green energy sources, moving to more socially sustainable manufacturing practices and aligning goods and services with society's values is now a commercial imperative. Businesses are under pressure from a broad range of stakeholders to make major urgent adjustments to their strategies and business models in the transition to a low-carbon and more socially equitable world. These pressures can increase business costs, damage asset values as investor capital moves out of carbon-intensive assets towards cleaner businesses, and can undermine the long-term viability of existing products and services. This change carries significant risks and opportunities and more than half of *Risk in Focus* interviewees raised environmental and sustainability as a core risk topic that has firmly come to the fore over the past 12-18 months.

This would not be such an issue if companies fully understood their environmental impacts. However, in many cases businesses have a limited understanding of the repercussions of their activities. One CAE confided that their company does not understand what environmental harms may be caused by the synthetic materials used in its core products.

Companies that fail to act—by mapping their activities, products and by-products, strategising and innovating—may soon lose the unwritten social contract that allowed them to operate in the first place. Those that lead the charge on environmental sustainability will quickly claim market share, pushing laggards into obsolescence. Expect the pace and scale of adaptation to accelerate.

**Climate change and  
environmental sustainability**  
is now seen as a top five risk  
by as many as



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# CLIMATE CHANGE AND SUSTAINABILITY IS NOW A PRINCIPAL RISK

## An internal audit perspective

Businesses that drag their feet on sustainability are jeopardising their futures. The third line therefore has an opportunity to cement its standing and demonstrate its value by “joining the dots” on this risk. Internal audit can assess what exactly it is that the company is doing to ensure its longevity by aligning its mission, values and strategy with the rising sustainability agenda, then flag any gaps between the company’s ambitions and what it is doing in practice to fulfil those ambitions.

At a top level, this should start with reviewing what strategic actions are being taken by the business, such as establishing clearly defined and actionable sustainability goals that are aligned with existing frameworks and guidance such as ISO 26000 and the UN’s Sustainability Development Goals (SDGs). This is the company’s roadmap and provides something tangible to audit against.

These goals may include minimising environmental impacts such as deforestation, chemical waste, greenhouse gas emissions and water consumption; ensuring human rights and the promotion of economic inclusion through the supply chain; and developing products and services that do not harm people or the planet.

Internal audit may choose to carry out its formal audit work through an ESG lens, scoring auditees using sustainability metrics to show how well various functions and business units perform against the company’s stated sustainability goals. This may include reviewing risk governance in the first and second lines, namely seeing how clearly defined roles, responsibilities and ownership of the chosen goals and related risks are.

Internal audit’s value also lies in its consultative supporting role. Climate change and sustainability risks need to become a central theme in corporate decision-making and CAEs should seek a seat at the table in strategy development meetings. When big decisions are being made about large capital projects, the development of new products or supply chain management, CAEs should raise their hand if they believe climate and sustainability risks are being overlooked, where possible using hard data or other tangible, objective information to make their case.





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# CLIMATE CHANGE AND SUSTAINABILITY IS NOW A PRINCIPAL RISK

## An internal audit perspective

### Questions for internal audit

- Is climate change and sustainability central to the company's values, mission and strategic goals?
- Has the business established sustainability goals and are these aligned with the UN's 17 SDGs?<sup>20</sup>
- Is the business at risk of becoming obsolete or facing reputational backlash for its activities?
- Is the business taking climate change and sustainability seriously, for example by investing in projects that will future proof its products and services?
- Is scenario planning being employed to prepare the business for any climate-related physical and political risks that may jeopardise its future?
- How valid are the data on which the organisation models its environmental impacts?
- What initiatives are there to reduce the organisation's greenhouse emissions and move away from harmful or unsustainable manufacturing processes or materials? What progress is being made on these?

“Climate impact risk is becoming much more important. The semiconductor industry actually uses quite a lot of energy, not only directly but throughout the value chain. How much CO2 are the machines we produce going to use and what can we do about that? This will become increasingly important.”

ACC, the Netherlands,  
technology company  
traded on Euronext  
Amsterdam





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# SUPPLY CHAIN STRAINS AND THE RACE TO FLEXIBILITY

## The research data

**The pandemic stress-tested supply chains and many companies may feel like they have come through the worst. As demand recovers, however, supply chains are coming under immense strain. Just under a third (30%) of CAEs put *Supply chains, outsourcing and 'nth' party risk* among their top five risks (#9, down one place from last year albeit with a slightly higher share of the vote).**

Two-fifths of CAEs we interviewed raised the issue of supply chain risks, from the simple ability to secure parts and products today through to more forward-looking considerations, like developing flexibility and co-locating suppliers at the site of production in the context of a pandemic-constrained world to reduce transport costs and improve supply chain certainty.

One thing that recent events have shown is how supply issues can take months to emerge. Many companies reduced their production in 2020 in the face of weakened demand, leading their suppliers to dial down their own output. Demand jolted back in 2021 as economies recovered creating supply bottlenecks and preventing companies from fully benefiting from the restart. This effect has been particularly

acute in the semiconductor industry, where shortages have had a cascade effect that has hamstrung as many as 169 sectors in some way<sup>21</sup>, from consumer electronics to car manufacturing. This shortfall is expected to last through 2021 and potentially into 2022.

The V-shaped recovery in demand is currently contributing to new inflationary pressures (see page 29), but a bigger risk than rising costs is short supplies of critical components causing production delays and lost revenues. If a business is unable to secure vital supplies, then it cannot sell its products. Complicating matters is the unpredictability and unevenness of the economic recovery, which is likely to make demand forecasting a persistent challenge for every link in the supply chain. This is

a balancing act. Double ordering today to stockpile and prevent future shortages may cause substantial overshoots, increasing inventory costs.

Senior management and the board will need to be confident that inventory management risks have proper oversight, that supply chain data and technology is being employed to best effect and that short-term and long-term contingency measures are being weighed up to ensure greater supply chain security and flexibility. This will require a change in mindset, from prioritising the lowest price for goods towards greater certainty and resilience.



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# SUPPLY CHAIN STRAINS AND THE RACE TO FLEXIBILITY

## Playing politics

Geopolitics continue to play into this trend. In May 2021, the European Commission unveiled plans to cut dependency on Chinese and other foreign suppliers in six strategic areas including raw materials, batteries, pharmaceutical ingredients, hydrogen, semiconductors, and cloud and edge technologies, freezing a long-awaited trade and investment agreement.

The power struggle between the US and China also continues virtually unabated. Not only are most of the elevated tariffs imposed at the height of the trade war instigated by the Trump administration still in place, affecting over half of all trade flows between the two countries<sup>22</sup>, the current administration is stepping up its own efforts. The Strategic Competition Act of 2021, which has support from both Democrats and Republicans, defines China as a competitor in multiple areas, including

economics, technology, and military security. Far from being a temporary concern, trade wars and the impact of geopolitics on supply chains will have to be carefully considered for the foreseeable future.

“There are supply chain issues to think about and the flexibility to scale up and down depending on the pandemic and demand. There will be an increase in sourcing from nearby countries to reduce supply risk. For companies with components coming from different parts of the world, they are reviewing their supply chains to see how to structure them for the future, even if the pandemic soon passes.”

ACC, Sweden,  
food retail group listed on the  
Stockholm Stock Exchange

<sup>22</sup> US companies are bearing the brunt of Trump's China tariffs



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## An internal audit perspective

Supply chain risks will typically be a far higher priority for internal audit functions in businesses that deal in physical goods rather than services, the latter benefitting from scalability. Senior management should be working closely with procurement and supply chain management functions to determine how exposed they are and what actions need to be taken to secure vital supplies during any potential bottleneck phases.

The third line may seek evidence of scenario and contingency planning that will enable the company to access new sources of critical supplies. The more complex, diverse and outsourced the supply chain, the greater the risk. The company should be identifying the highest-risk suppliers to focus on in the first instance and internal audit can help to validate the means by which key suppliers are risk-categorised

As supply and demand reach closer equilibrium as the recovery progresses, a longer-term view is required. The most operationally resilient businesses will have built flexibility into their supply chains, allowing them to toggle between vendors as required, and reviewed their forecasting and inventory management strategies to add any necessary slack to account for possible future chain disruptions.

### Questions for internal audit

- How well is the company currently coping with supply/demand shocks? Were these foreseen?
- Is there evidence of concentration risks, with supplies coming from a small number of vendors or from a single country?
- How well coordinated are procurement and supply chain management functions?
- Is the business reviewing its supply chain strategy, for example moving away from Just-In-Time inventory management?
- Is the supply chain sufficiently flexible such that the business can dial up/down production and source new suppliers when necessary?
- Are the procurement function's planning and forecasting modelling efforts effective? Have any necessary adjustments been made and are these based on sound data and analysis?



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# HEALTH AND SAFETY AMID THE CONTINUED COVID-19 THREAT

## The research data

**22% of CAEs put *Health, safety and security* among their top five risks (#12, up two places from last year). The events of 2020 set a new precedent, the pandemic being far more widespread and persistent than any health crisis anyone has experienced in their lifetimes. This has brought the safety and wellbeing of people to the fore—and remains a concern as the trajectory of the pandemic is still uncertain.**

“SARS-CoV-2 is not going away,” the CEO of vaccine manufacturer Moderna said earlier this year. While vaccine rollouts in the developed world are progressing, no-one knows for certain how the pandemic will play out. In an op-ed authored by six epidemiologists, physicians and advisers, governments were called upon to face an “inconvenient truth”: the fight against the “remarkably resilient virus” will be long and slow.<sup>23</sup>

The spread of coronavirus has impacted all manner of risks—from supply chain stability to financial strength, cybersecurity resilience to macroeconomic factors. From a pure health and safety perspective, the challenge is in ensuring that appropriate steps are taken to safeguard the physical and mental wellbeing of staff, customers

and suppliers at the same time as maximising productivity and minimising business interruptions. This was a dominant theme in this year’s interviews, nearly half of participants raising concerns over ongoing uncertainty surrounding the pandemic and the need to prioritise the health of workers.

The larger and more geographically diverse an organisation is, the more complicated and higher risk this is. Vaccine distribution has skewed towards developed countries and it is estimated that low-income nations may not receive enough doses to vaccinate all adults until well into 2022, possibly later, as demand outstrips supply<sup>24</sup>, though the decision by the G7 to donate shots could accelerate this.



<sup>23</sup> The Forever Virus: A Strategy for the Long Fight Against COVID-19

<sup>24</sup> Coronavirus vaccines: expect delays



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## HEALTH AND SAFETY AMID THE CONTINUED COVID THREAT

Further, new variants such as the “Delta Plus” strain raise more questions. It is not clear if future variants will prove to be more transmissible, more harmful or more resistant to vaccines. What is clear is that SARS-CoV2 will continue to mutate, therefore ongoing access to mitigative medicines will have a fundamental influence on countries’ ability to cope.

This could have serious disruptive effects, especially for businesses with global footprints and with extensive outsourcing to the worst-affected regions in the world and where vaccine access is limited.

As lockdowns ease in developed countries and businesses determine how to move forward—whether by maintaining remote working, returning on-site or balancing the two with a hybrid approach—human resources functions, health and safety officers and senior management will need to remain vigilant. This will require tracking the course of the pandemic and following government guidance or mandates in response to any possible further waves of infection across relevant geographies. It also means being attentive to the needs and psychological wellbeing of staff. Organisations have a legal obligation to protect their employees and others from harm, so health and safety will remain a prominent risk, even as the pandemic is gradually contained.

“Health and safety for our business was always of paramount importance because a lot of things can happen in the customer journey. The important thing now in the context of the pandemic is how to ramp up. We need to make sure that the customers’ trust is still with us and they believe that we are doing the utmost to manage this as the business picks up again. It is too early to audit now because plans are constantly changing. But this is on my list for sure.”

CAE, Germany,  
FTSE 100 travel operator





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# HEALTH AND SAFETY AMID THE CONTINUED COVID THREAT

## An internal audit perspective



Companies responded swiftly to protect their workforces and customers in 2020. The almost seamless transition to contact-free working may have developed a false sense of security. As lockdown measures are eased and more of the workforce returns on-site, health risks will increase as more people occupy shared physical spaces. There are simple practical steps that organisations can take like increasing social distancing, staggering shifts, regularly cleaning communal areas, improving ventilation, and providing hand-sanitising facilities, and these basics should already be well covered. If not, the third line should be raising the flag.

While health and safety is a long-established risk, outside of heavy and extractive industries such as industrial manufacturing and mining it is not something that internal audit has commonly looked at. Companies have

typically relied on external health and safety auditors for this work and so internal audit may feel that it is in unfamiliar territory.

But the third line must now step up to the plate. In small organisations this should be a relatively simple exercise involving spot checks and assessing staff awareness and behaviour. For multinational organisations, the third line may seek evidence that safeguarding measures are being reviewed on a risk-based, country-by-country basis. Going deeper, internal audit can form an opinion on how effectively staff and customer safety is being risk assessed on an ongoing basis, in the context of the business's various activities and taking into account the potential for further waves of COVID-19 infections.

There is also the psychological dimension to consider. HR functions should be raising awareness with staff about how to protect their mental health. Internal audit may consider it appropriate to perform a formal audit of staff wellbeing for example via an independent survey, although simply checking that HR is sufficiently assessing and attending to workers' needs may be enough. The psychological health of personnel may also be something that the third line "picks up" from soft human cues as it moves around the organisation conducting more technical controls- and process-oriented audits, in the same way that it can check the temperature of the organisation's culture.

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# HEALTH AND SAFETY AMID THE CONTINUED COVID THREAT

## An internal audit perspective

### Questions for internal audit

- Is the health and safety of customers being sufficiently prioritised and what measures need to be embedded and monitored with the recovery of business activity?
- What evidence is there that the HR function is prioritising the health and safety of staff in the context of a return to the workplace? Is a health and safety strategy in place?
- Has there been an increase in staff, customer or supplier complaints regarding their treatment or concerns over how the business is handling their physical safety and psychological wellbeing?
- Has the organisation already demonstrated that it can effectively manage this moving risk? Is it ready to manage this as business activity returns?
- Is a risk-based approach being applied to the various geographies in which the organisation is present? Are health and safety measures appropriate to the level of risk in that country?

“Health will continue to be a major risk for the next year at least. Despite the vaccine no one really knows for sure exactly how long this is going to help and it doesn’t offer 100% protection. There are a lot of discussions about how to keep social distancing at the offices. At the end of the day, health continues to be a real concern and there’s risk of more contagion.”

ACC, Spain, property  
development company



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## About Risk in Focus

For the past six years, *Risk in Focus* has sought to highlight key risk areas to help internal auditors prepare independent risk assessment work, annual planning and audit scoping. It helps Chief Audit Executives (CAEs) to understand how their peers view today's risk landscape as they prepare their forthcoming audit plans for the year ahead.

This year, *Risk in Focus* 2022 involved a collaboration between 12 Institutes of Internal Auditors; in Austria, Belgium, France, Germany, Greece, Italy, Luxembourg, the Netherlands, Spain, Sweden, Switzerland and the UK & Ireland.

The survey elicited 738 responses from CAEs across Europe, an all-time high for this research project. Simultaneously, a sample of 35 Chief Audit Executives (CAEs), 12 Audit Committee Chairs (ACCs) and 3 CEOs from across these countries were interviewed to provide deeper insights into how these risks are manifesting and developing.

