

Internal Audit (IA) Role in Business Performance Improvement and Organisational growth

Introduction

As business leaders, one often gets disquieted about ever-changing business environment and cannot help but feel unease whether 'all will work well' or fluster whether all is indeed working well. As CFOs, how many times have you been unnerved by external volatility, execution missteps wildcard risks and regulation handicaps. Thus, the pressure on the leaders is enormous, and mounting.

Enter the Internal auditor, who is seen increasingly as a Business Partner who can add value to an organisation's growth or better still, 'share' these worries.

In fact, gone are the days when IA would traditionally review compliances and internal controls and assure the management. Things have changed dramatically over the last couple of years as he is increasingly seen as Business Partner. The broad-based, evolved role resonates in Institute of Internal auditor's definition of Internal Audit given below.

❖ Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations.

While the role of IA in risk management, control evaluations is generally well understood, how does the IA help organizations improve business performance?

Though most organizations are confident in monitoring the two important non-financial drivers of growth viz., customer satisfaction and operational efficiencies, 'measuring and monitoring' of other key non-financial drivers of long-term corporate performance (such as talent, innovation, brand reputation, employee commitment etc.) continue to pose myriad challenges towards achieving sustainable growth so that it permeates all organizational activities.

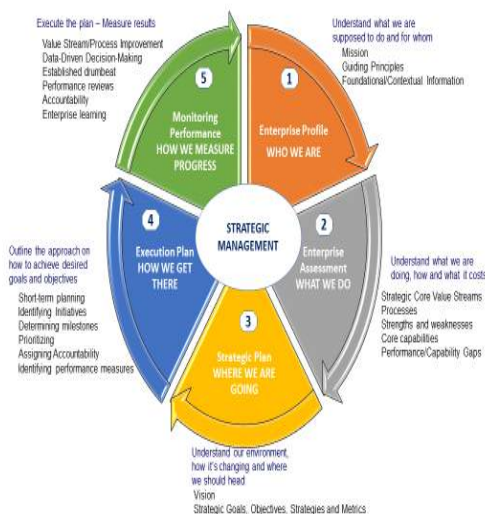
So, what is Business Performance Management and how does the IA help?

Business performance management is a set of management and analytic processes that enables the management of an organization's performance to achieve one or more pre-selected goals.

In this article, we discuss how the Internal Audit process can play a significant "Strategic Business Partner" role in different situations with regard to strategic transactions besides assisting critical business processes to improve performance of the organisation through evaluation / monitoring and measurement techniques to help bolster the stakeholders' confidence.

Business Performance Improvement

Performance Improvement Strategy comprises of 5 components as shown below.



Support in Growth

The ever expanding global markets

enhance business opportunities. Organisational growth comes either in an organic or in-organic manner. Scalability is the focal point in the former while culture plays a crucial role in the latter form of growth. Unless properly addressed, various challenges associated with business such as economical/ political/ social/ technological/ compliance/ operational etc. pose threat with potential danger to limit the scalability and sustainable growth of any organisation.

In short, both risks and rewards come together hand in hand and Management needs to strike the right BALANCE to achieve its objective of protecting and maximizing the stakeholder's wealth.

By virtue of his position and cross functional knowledge, IA can 'Add Value' to the business improvement as a process by itself in general besides examining the IA role in specific situations. As a strategic business advisor, Internal Audit can:

- o **Help locate gaps in operational areas where scalability could be suspect (Most important because many times, growth is imbalanced and certain functions get overwhelmed by the enormity of the fast-paced changes impacting**

them). For example in a high growth company systems and processes may get ignored as the organisation is focused only on sales.

- Identify company-wide cost improvement opportunities
- Analyse and offer recommendations on clustering common activities through business process engineering techniques and enhance business performance
- Provide key insights that focus on risk, minimize the Weakness and Threat factors and potential red flags in Strengths and opportunities and mitigate them

Competitive advantage through Risk Management:

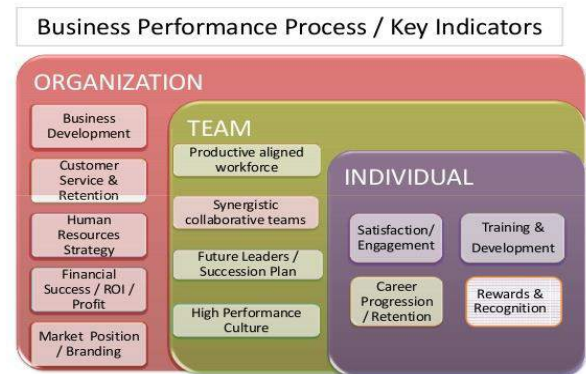
Research results reveal that Organisations with more mature risk management are leveraging risk management to make them agile, adaptable and more robust. Change management in such organisations is generally smooth and successful.

Sound risk management helps Organisations navigate crisis situations more effectively.

Credit ratings were found to be better in organisations with sound Risk Management thus attracting investor funds at favourable terms and cost.

Linking Business Performance to IA

The 3 layer dissection of typical business performance process together with key indicators is shown in the below diagram:



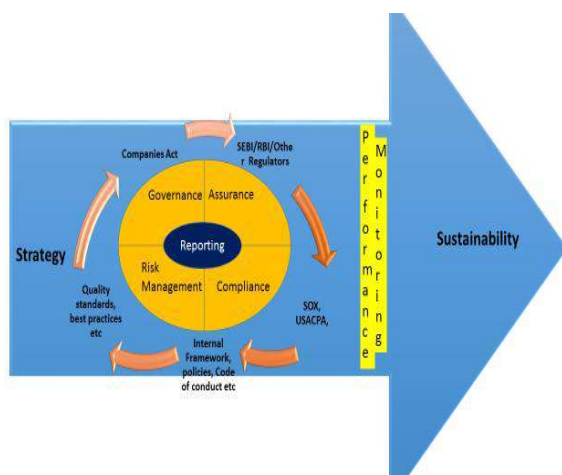
The diagram below depicts the intertwined relationship between various functions in typical value creation oriented organisation.



Organisational pursuit of improving its performance is best supported by effective evaluation of metrics and their impacts.

An enterprise could benefit from sustainable and improved performance through effective combination of internal audit and monitoring functions. The figure above explains the bridging importance of IA and filtering function of monitoring in realising Strategy into sustainable business results.

Internal audit serves as a subject matter specialist on processes around Strategic initiatives, challenges and changes in the organisation. Internal audit enables Business performance improvement when the IA objectives are aligned with the Stakeholders' expectations and Business objectives.



Empowered by such a charter with clear mandate and objectives, and adopting **blended approach** as

assessor and advisor IA can help achieve business objectives by

- Focussing on high risk areas to drive value and focus on improving bottom-line, such as cost reduction measures.
- Coordinating with other relevant functions such as risk and assurance activities to ensure better governance and risk management
- Bench marking the current standards and practices with best practices to improve/stretch business performance
- Developing 'Rapid problem diagnosis and Quick fix' approach to fix known problems or identify root cause/reasons to reduce surprises.
- IA can monitor, by way of Action Taken Report, progress on resolution of issues

Enterprise value is enhanced through consultative approach and advisory orientation of internal audit (as earlier indicated in IIA's definition).

IA plays an advisor/facilitator role and serves as a catalyst for change when they help management identify better ways to measure performance by seeking answers to certain key questions and ensuring objective evidence:

- Are performance measures in

place?

- Are measures focussed on factors that are aligned with strategic goals?
- How are performances measures used and reported?
- Are these measures accurate and quantified properly?
- Are incentive programs aligned with these measures?

This data can be persuasive in performance improvement efforts.

IA Value Add – Contributions

We discuss a few situations detailing how IA could support strategic business initiatives such as M&A, ERP system implementation besides providing value add services in other critical business areas such as Finance, Customer, Supply Chain, People (Talent) etc.

Market Growth / Customer relationship

In their endeavour for growth and owing to pressure to deliver, teams could many times be forced to compromise on strict implementation of KYC procedures, which show adverse results much later, when it too late. For instance, if a client is blacklisted under the Anti-money laundering regulations, dealing with such entity could lead to vexatious issues for our organization. Perhaps a

‘stitch in time’ through diligent adherence to the stipulated process could have saved the proverbial ‘nine’ and this is where IA could help.

The criticality of this aspect of business management is such that it can make or break business. IA can help in:

- Reviewing alignment of the market penetration and customer relationship plans vis-à-vis Organisation growth strategy
- Product Profitability analysis
- Reviewing marketing and sales performance, pricing, promotion, and product strategies to help improve margin
- Processes to review that the discounts and promotions are reaching the last mile (end customer) so that the spends are effective
- Reviewing customer service management and collections process.

Supply Chain Management (SCM)

SCM is one area which offers tremendous scope for cost reduction in any organization. And given the enormity of financial decisions that could bind and impact the organization, it is critical to maintain

sound internal checks and balances in this domain. IA with his domain and controls knowledge is well poised to help in this regard.

SCM is one of the key competitive differentiators to help delivering reduced cost, and increase value. IA can add value by

- Health check of supply chains through data analytics across operations, tax and risk
- Assess impact of environmental, sustainable and carbon aspects
- Reviewing performance vis-à-vis strategic decision-making, operations, Management, tax and risk.
- Review Working Capital (All components like Inventory Debtors and Payables) management parameters with industry comparisons and internal targets and help debottleneck the processes to ensure optimum working capital and liquidity.
- Unlocking value of investments by analysing money blocked in unutilised/under-utilised assets, inventory obsolescence, inventory movements (slow, non-moving, in transit etc.), sticky debtors, cash flow management

- Input /Output and yields analysis in Manufacturing

Finance, Accounting and Reporting

- Reviewing finance operating model and help implementing appropriate financial systems
- Reviewing outsourcing, offshoring and shared service centre arrangements
- Help implementing and reviewing cost and profitability management systems
- Reviewing Accounting control or process support

Merger and Acquisitions (M&A) Process assessment

In a typical M&A activity, management would like to enhance in-house expertise to enhance deal value and mitigate M&A risks. It would like to ensure consistency of improved performance in its critical activities.

IA could play an active leading role in both pre- and post- deal close phases as below:

- Assessing and determining the organization's readiness for the transaction. It may call out the impact that the acquisition and its integration, or the divestiture, may be having on other parts of the business

- Performing Bench marking analysis of current processes against leading industry practices to identify improvement opportunities for key processes
- Designing framework for process improvement; prioritising the improvement opportunities and developing a road map for process maturity over target period thus, enabling improving efficiencies.
- Assessing the program management throughout the transaction life cycle, to identify any improvement opportunities.
- Alert the organization on potential risk, control or regulatory issues that would cause the organization to overpay or undervalue.

During the post-transaction period, IA could help ensuring the control environment has sufficient rigour by assessing organizational efficiencies and ascertaining proper control monitoring of changes in processes.

ERP system implementation

In most situations, it has been observed that ERP has been implemented but does not quite serve the intended purpose. There may still be areas where operations are not linked up or manually continued.

Optimal ERP implementation is crucial in today's world where the Information Technology plays a crucial role in efficient transacting of

business and assist/provide quick data for timely decision making. Business would primarily aim for improved operational efficiency and accuracy in reporting.

Internal audit adds value through critical evaluation of the ERP implementation strategy, process design, functional and controls design.

IA could evaluate on-going implementation project risks such as mapping issues, scheduled delays, functional and acceptance test results, cost over runs to prepare Gap summary report, highlighting various improvements required to ensure functionality of the system by the go-live date.

Based on its experience, IA ensures mandatory controls are not removed in the process of re-engineering and adequate compensatory mitigating controls are in place before the existing system is replaced.

IA can certify the go ahead go-live date(s) after ensuring systems are functional as desired.

Post implementation IA can evaluate whether the functionality of ERPs are optimally utilised for business or is only used as an accounting system.

Conclusion:

Internal audit is most effective when it is focused on the critical risks of the business, beyond looking only at adequacy of financial reporting, compliance and controls.

As concerns among key stakeholders – Top management, audit committees, and boards – shift from traditional controls and finance issues to strategic business risks, internal audit has to adapt to meet changing priorities. Reactionary approach is changing and expectation is on a proactive approach. No surprises. Don't report, proactively prevent.

Internal audit to become part of the organization's strategic leadership should take steps with updating the internal audit mandate to clearly position the department as a critical risk management player that responds to risks with a process aligned with the organization's strategic objectives.

To be seen as a relevant and valuable contributor to the organization, internal audit must continuously monitor and focus on those risks as they affect the organization's strategies and objectives – help the organization assume the right risk at the right time.

It is critical for IA to adopt integrated thinking and view business more holistically in view of the multitude of dependencies and impacts that exist.

IA by virtue of its business knowledge and access to all functions/people in an organisation can play an effective role/Add value in Business Performance improvement and thereby assist in organisation growth.

Are the business leaders listening?

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