

2023

RISK IN
FOCUS

Board
Briefing



BOARD BRIEFING: Risk in Focus 2023

Boards should harness internal audit to navigate the 'perfect storm' of high-impact interlocking risks

In 2022, a 'perfect storm' of high-impact, interlocking risks threw many businesses into a permanent state of crisis. Following an ongoing pandemic, the war in Ukraine intensified supply chain failures, fuelled inflation and energy price increases.

Boards must rapidly adapt to the new reality of heightened geopolitical instability, climate-related natural disasters, looming recession, an accelerating cost of living catastrophe in Europe, food shortages, employee welfare and skills deficits, and a rapidly industrialising cyberattack landscape.

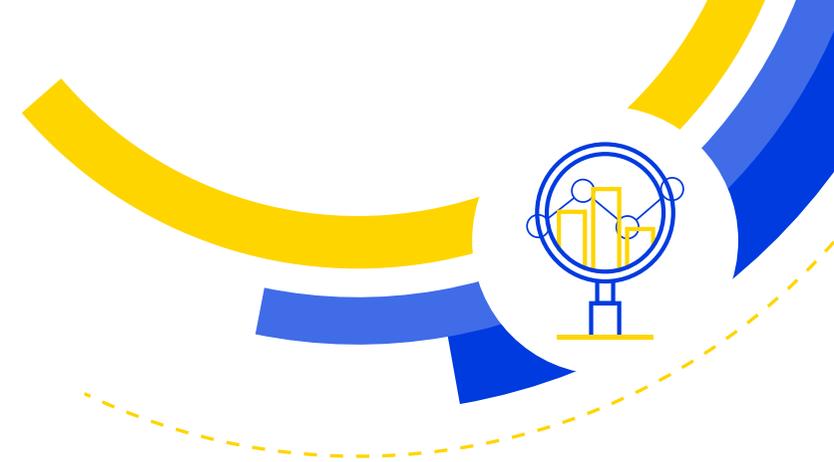
The key to success will be for senior management teams and boards to stop seeing sudden, systemic organisation-wide risks with contagious, unpredictable ramifications throughout the enterprise as Black Swan events: they are interlocking elements of a continuous storm that will blow through Europe in 2023 and beyond.

Chief audit executives have identified five key areas of focus to help boards navigate these headwinds: geopolitical uncertainty, climate change, organisational culture, cyber and data risk, and digitalisation and artificial intelligence.

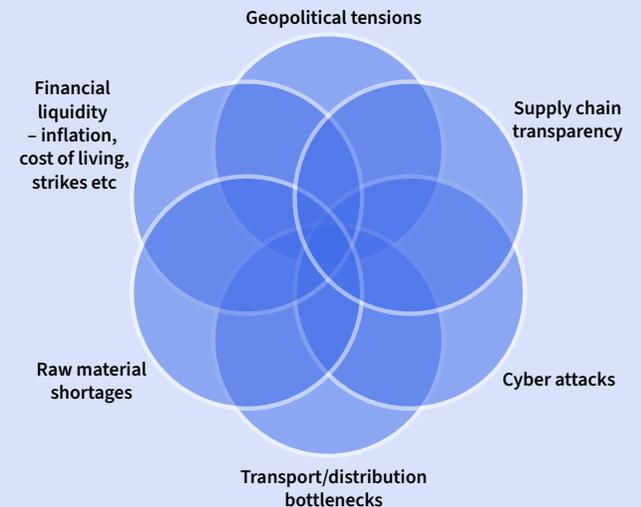
For example, fast-moving human capital and climate-related risks require a strategic response. While changes to laws and regulations are important from a compliance perspective, chief audit executives can help boards undertake deep-rooted cultural, governance, and risk management transformations to meet these challenges.

In addition, taking a strategic approach to cybersecurity and data governance can help organisations combat industrialised hacking attacks, ensure that reporting on issues such as sanctions compliance and climate change is accurate, and pave the way for effective digitalisation at a time when automation is a key tool for realising strategic goals, including in human capital to tackle skills shortages.

Finally, chief audit executives are ideally placed to help organisations tackle employee burnout and changing attitudes to employment. Working with the board to use the Environmental, Social and Governance agenda to discover and communicate purpose as well as protect staff wellbeing can help win the all-important war on talent.



Venn Diagram Illustrating the Perfect Storm of High-Impact Interlocking Risks



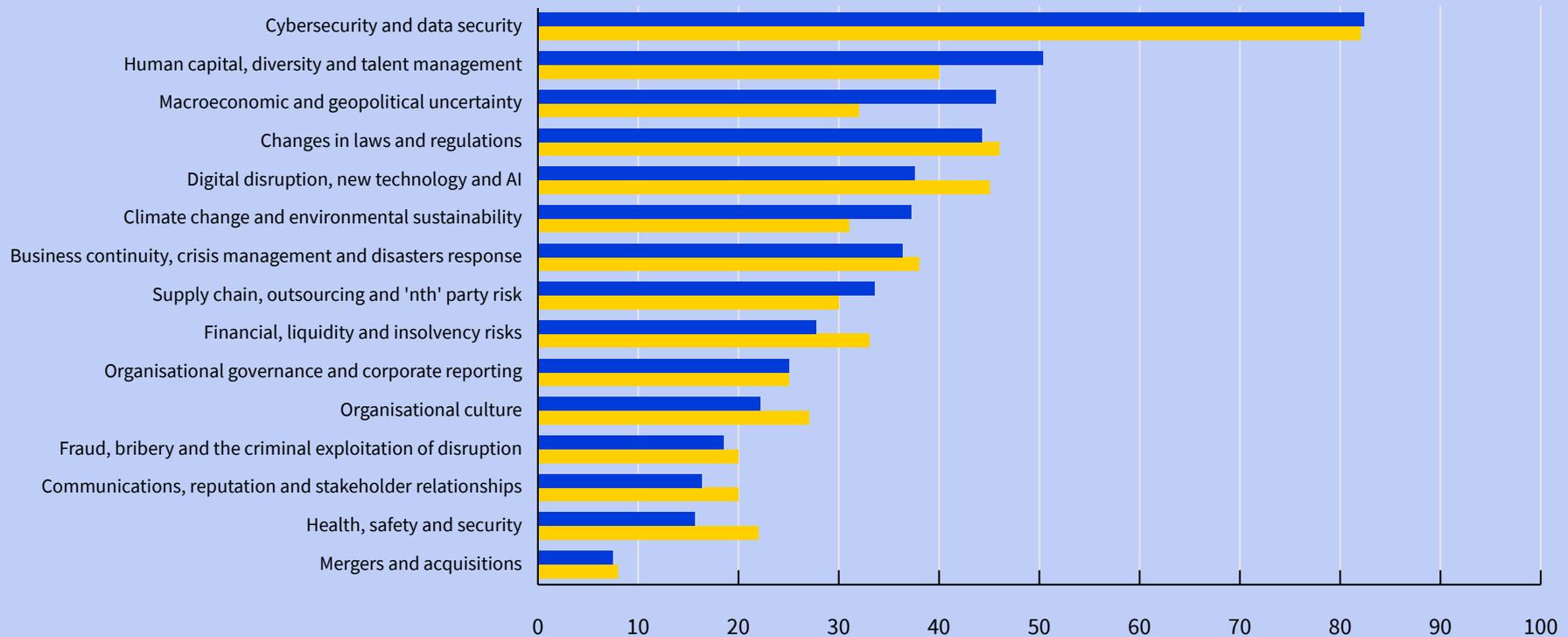
Key findings: 2022 vs 2023

What are the top five risks your organisation currently faces?



■ 2023
■ 2022

Human capital risk moves into second place this year followed by macroeconomic and geopolitical uncertainty.



CALL TO ACTION FOR BOARDS

1. Focus on systemic risks that create vulnerabilities in many parts of the organisation simultaneously and ensure risk assessment and risk management efforts provide the board with clear oversight of such risks
2. Ensure that governance, risk management and control efforts are coupled to strategic risks
3. Check that the board's risk appetite is up to date in order to provide clarity in rapid strategic decision making
4. Work with the chief audit executive to ensure the internal audit function spends as much time as necessary on emerging strategic and systemic risk areas
5. Provide the chief audit executive with the profile, authority and resources to properly support the organisation in achieving its strategic goals



HOT TOPICS

MACROECONOMIC AND GEOPOLITICAL RISK, EMERGING AND STRATEGIC RISK

Auditing in a time of crisis

Chief audit executives ranked macroeconomic and geopolitical risk as the third most pressing threat in the Risk in Focus 2023 quantitative survey, up from seventh place last year. On the other hand, they ranked it just 15th in terms of where they spend their time, which they expect to rise only to 13th place over the next three years. Given the pressure such high-impact, fast-moving events place on financial and liquidity risk, for example, the lack of attention to this key area seems either short-sighted or untenable. Board members could use these results to discuss whether internal audit's time is currently being focused on the risk areas of highest strategic importance, or whether they need more resources to give these emerging strategic risk areas sufficient attention.

In the first quarter of 2022, as a result of the War in Ukraine, sanctions risk arose as a major area of focus with internal auditors

in some sectors supporting their businesses in maintaining up-to-date risk assessments and strengthening controls for screening suppliers and shareholders. Data governance is key to increasing transparency in these areas to avoid compliance-related fines and legal action.

Following the conflict in Ukraine and increasing tensions with China, supply chain risks pose existential threats to both organisations and life. The nature of extended enterprises means that such risks cut across all areas of the business and demand a strategic (rather than operational and tactical) response from boards and internal audit teams. Supply chain visibility is vital, including the ability of businesses to digitally model their supply chain structures to stress test and improve them.

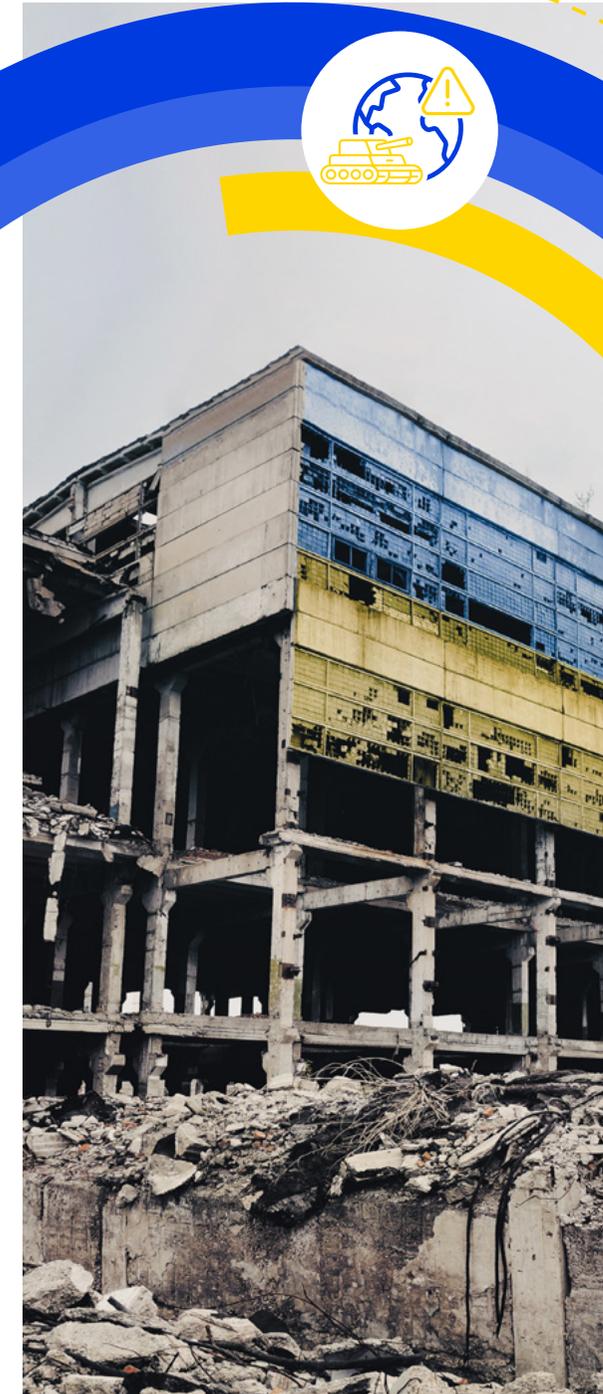
Large-scale, interconnected risk events are becoming systemic. Traditional operational

crisis management teams are not equipped to deal with non-stop emergencies – the effects of which can jump rapidly and unpredictably through the enterprise. An up-to-date risk appetite can provide greater clarity to rapid strategic decision-making in times of crisis.

3rd



Chief audit executives ranked **macroeconomic and geopolitical risk** as the **third most pressing threat**, up from seventh place last year.



HOT TOPICS

CLIMATE CHANGE AND ENVIRONMENTAL SUSTAINABILITY

Transition to climate change auditing

Climate change has become one of the most dynamic, fast-moving areas for businesses, according to the Risk in Focus 2023 quantitative survey of chief audit executives. It moved from eighth to sixth place in the risk rankings – and respondents expect it to move to third place in three years' time. The qualitative interviews and round table sessions revealed that many chief audit executives are working to integrate climate change aspects into every audit assignment.

The Conference of the Parties (COP26) set new targets for net global emissions. European Sustainability Reporting Standards (a key component of the Corporate Sustainability Reporting Directive) and the International Sustainability Standards Board's own rules should be finalised by the end of 2022. Internal audit functions need to help companies rapidly get to grips with developing key performance indicators around these rules and robust data reporting systems that are accurate and timely.

Internal audit also has a key role to play in providing assurance to the board that the organisations' climate-related objectives are linked to its core strategy, have adequate risk management to ensure that strategy is achieved, and have robust data and reporting structures, relevant KPIs and that they comply with international standards. Boards must ensure that internal audit helps in the development of such frameworks from the outset to make certain that risks are managed in line with risk appetite. The business should have a firm grip on how and why it does business with key third party suppliers and seek assurance that they are not a weak link in its climate change strategy.

Given increasing pressure from shareholders and stakeholders on climate-related reporting, a key risk is that legal, voluntary and marketing statements are wrong. Organisations must not view climate change disclosure as a compliance exercise. Instead, applying an Environmental, Social and

Governance (ESG) lens to the issue provides businesses with the transparency they need to both avoid reputation risk from charges of green-washing and to assure stakeholders that the organisation is on the right path to achieve net zero objectives.



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HOT TOPICS

HUMAN CAPITAL, DIVERSITY AND TALENT MANAGEMENT

The human factor

Human capital, diversity and talent management ranked as the second highest threat in Risk in Focus 2023 qualitative survey: 50% of chief audit executives rated it as a top five risk. Respondents said it would retain its new second-place position over the next three years.

The pandemic has accelerated skills shortages as many mature workers have retired and younger people have favoured education or alternative career routes. A leeching of institutional knowledge and burnout has left many organisations with hard-to-fill gaps for key projects, such as digitalisation – a process that promises to alleviate such shortages in future.

Businesses must tackle wage inflation, skill shortages and the need to offer better psychological support to staff. That entails retooling their organisational culture.

Organisations must create a core, purposeful and diverse culture to accommodate, for example, hybrid working and inclusion, while remaining highly operational, productive and functional however people choose to work.

Some boards fail to either articulate or communicate a sense of purpose that connects with the workforce and the communities in which they operate. The European Union's pandemic recovery plan, NextGenerationEU, is built on the UN's Sustainable Development Goals. Internal auditors can play a key role in supporting the board, by using such a framework to help bridge potential gaps between the organisation's purpose, the workforce and external stakeholders. Refreshing a business' Environmental, Social and Governance framework can help it strengthen its strategic human capital, diversity and talent management goals.

Chief audit executives can provide assurance that their organisations have created governance structures with adequate risk management controls that are aligned with strategic talent objectives. Assignments may include assessing the current culture and helping management develop a roadmap for change and helping ensure the desired strategy is well articulated and communicated. The right tone set at the top by the board and senior management is the key to success.

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HOT TOPICS

CYBERSECURITY AND DATA SECURITY

Auditing at the speed of crime

Cybersecurity and data security remained the number one threat for chief audit executives in the Risk in Focus 2023 quantitative survey: 82% ranked the risk in their top five. In addition, internal auditors said they spent most time and effort working on this area.

Ransomware has been a major threat in 2022, but the nature of cyberattacks is changing. Relatively inexperienced hackers now take advantage of a sophisticated ransomware-as-a-service industry. More ominously, “killware” attacks have also increased, targeting critical infrastructure and threatening lives.

That means that cyber and data breaches impact not only the quality and availability of products and services, an organisation’s trustworthiness and reputation, but also its financial stability and very existence. Where businesses have robust defences, hackers seek entry via their less well protected third party suppliers or cloud-enabled systems.

The European General Data Protection Regulation places responsibility for data breaches and losses squarely on the shoulders of businesses – an approach adopted in Europe’s revised cybersecurity directive NIS2. These data protection rules are mirrored in the UK GDPR and moves are underway to strengthen the UK’s version of the NIS regulation.

Despite the intensity and gravity of cybersecurity and data security risk, many chief audit executives participating in Risk in Focus 2023 said boards often lacked either sufficient knowledge or interest in such threats. While chief audit executives can play a key role in helping spread cyber and data best practice, the interest and support of the board is also critical.

Internal audit has an important role in giving assurance that an organisation’s cyber and data controls and policies, including

access rights, are properly implemented on the ground. In addition, in less mature organisations chief audit executives could facilitate breach simulation and tabletop exercises to strengthen defences and the effectiveness of remediation measures. With effective insurance protection difficult to quantify or purchase, businesses must do all they can to mitigate such risks with their own resources.

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HOT TOPICS

DIGITAL DISRUPTION AND NEW TECHNOLOGY

Switching to automatic

Between 2020 and 2021, the pandemic forced many organisations to accelerate lagging digitalisation efforts as sales and distribution networks needed to rapidly virtualise and as many staff moved to homeworking.

This year, chief audit executives responding to the Risk in Focus 2023 quantitative survey ranked digital disruption and new technology as the fifth most pressing risk, down two places from 2022. But in three years' time, they said it would rank as the second biggest area of internal audit effort. But rocketing inflation, pay increases and supply chain disruption threaten to sink such projects – despite the need for businesses to use new technologies to cut costs in the face of rising prices and to plug growing skill shortages.

Organisations that succeed in digitalising their businesses have strong innovation cultures, clear strategic vision and the right talent. Internal audit can play a key role in ensuring innovation and risk are well-

balanced in an organisation's culture – and that innovation efforts are properly aligned to strategic objectives.

In addition, sound data governance is critical, and boards must focus on strategic data risk. Data risk can impact many areas at the same time including, for example, reputational, regulatory, operation and financial risk. Yet unlike with other emerging systemic risks, organisations can better control such threats by tackling the root cause of the problem – poor data governance and management.

As well as supporting businesses at a strategic level, internal audit must keep abreast of new technologies deployed in their organisations, including artificial intelligence (AI). That can include working with the first and second lines to use the business' AI to automate audit processes. Internal audit can also assess whether the organisation has a credible roadmap for progressing to AI, as well as provide assurance over its

processes for evaluating their reliability and validity. But given the proposed tough new regulations on AI in Europe and similar rules in the UK, internal audit must have the skills and knowledge to assess the risk of bias associated with such cognitive technologies so that unfairness does not become baked into an organisation's infrastructures.



In three years' time, chief audit executives said **digital disruption and new technology would rank as the second biggest area of internal audit effort**, but rocketing inflation, pay increases and supply chain disruption threaten to sink such projects.



ABOUT RISK IN FOCUS

For the past seven years, Risk in Focus has sought to highlight key risk areas to help internal auditors prepare their 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 2023 involved a collaboration between 14 Institutes of Internal Auditors spanning 15 European countries which included: Austria, Belgium, Bulgaria, France, Germany, Greece, Italy, Luxembourg, the Netherlands, Slovenia, Spain, Sweden, Switzerland and the UK & Ireland. The highest number of European countries involved so far.

The survey elicited a record-breaking 834 responses from CAEs across Europe. Simultaneously, four roundtable discussions were organised with 39 CAEs on each of the risk areas covered in the report. In addition, we also conducted 9 one-to-one interviews with subject matter experts that included CAEs, Audit Committee Chairs and industry experts to provide deeper insights into how these risks are manifesting and developing.

The colour scheme for this year's Risk in Focus has been chosen as the same colours of the Ukraine flag, to express European solidarity and support with the people of Ukraine.

